HELPING AGRICULTURAL PRODUCERS RE-GROW RURAL AMERICA

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HELPING AGRICULTURAL PRODUCERS RE-GROW RURAL AMERICA

WEDNESDAY, SEPTEMBER 29, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Jim Talent (chairman of the committee) presiding.

Chairman TALENT. Good morning. I want to welcome the participants here today for the Small Business Hearing entitled, "Helping Agricultural Producers Re-Grow Rural America".

Your willingness to take the time to testify at this hearing about the opportunities and needs of agricultural producers as they pursue the development of value-added enterprises will provide us with invaluable insight into what Congress needs to do to assist these entrepreneurs.

Thomas Jefferson is of course, remembered for many things. In particular, Jefferson believed that the love of land and business, farming and commerce, was a part of America's fiber. But on several occasions Jefferson referred to the virtues of agriculture and the first importance of it to our nation's prosperity.

In his first inaugural in 1801 Jefferson wrote, "Encouragement of agriculture and of commerce as its handmaid, I deem one of the essential principles of our government and consequently, one of those which ought to shape its administration."

Although Jefferson's America was one in which the majority of the people were engaged in the production of food and fiber, I still believe that his spirit of admiration for agriculture and his dedication for the encouragement of agriculture, should remain true today.

He could never have imagined what our agricultural system has become. On average, each and every American farmer and rancher feeds and clothes himself and 126 other people. We have the safest, most abundant, and cheapest food system in the entire world. Our agricultural producers truly deserve to be honored for their hard work in providing our nation with the most affordable, most abundant, and safest food supply in the world.

This plenty that American producers provide to our citizenry has allowed our nation to prosper beyond any of the expectations of Jefferson. However, record high disasters and record low commodity prices are hurting America's farmers and ranchers. I believe it is one of the essential principles of our government to ensure that our agricultural system remains viable.

Plainly, we must help producers through these tough times. While it is obvious that producers need near-term assistance, it is important that we do not become short-sighted and loose vision of the opportunities for the future.

The future depends on the expansion of export markets for our farm products and the development of new and innovative producer-owned marketing systems, which is what this hearing is about. The current world demand, unfortunately, has been down for our agricultural products. This is directly affecting the livelihood of U.S. producers.

For example, historically the Southeastern region of Missouri, due to the availability of river transportation to the world market, has enjoyed at worst, a neutral basis, the difference between cash price and futures price, and often a positive basis on corn during August.

This August though, corn producers in Southeastern Missouri were faced with cash, farmgate prices as much as 50 cents below future prices. This downturn in world demand is caused by the Asian economic crisis and the unfair trade barriers on U.S. agricultural products by the EU, based on the fear of biotechnologically-enhanced crops.

On top of this, our government continues to hold our producers hostage by using food as a weapon in foreign policy through trade sanctions. We must as a government, advance the position of U.S. agricultural products on the world market.

This can be done through lifting of trade sanctions, aggressively negotiating the removal of EU trade barriers on biotechnologically-enhanced crops, ensuring the health of the emerging markets of Asia, and utilizing and strengthening the trade promotion programs of our government.

The greatest opportunity of the future is the development by agricultural producers of new and innovative marketing systems for their products. In August, two House Committee on Small Business field events were held to examine agricultural, tax, regulatory and trade issues that are critical to the agricultural community.

At both of these events an underlying theme surfaced from the witnesses: the need and desire of producers to reach up the agricultural marketing chain and capture some of the profits generated by processing their raw commodities.

Agricultural producers have an inherent, innovative quality and I was impressed that even during this time of extremely adverse pricing and production conditions, producers and farm organization representatives are energized about looking for inventive, entrepreneurial opportunities for the future.

I believe that our American agricultural system depends on these innovative producers and can be enhanced with the establishment of producer-owned, value-added enterprises. We need an agricultural system in which producers are the vertical integrators and no longer totally rely on the existing highly consolidated, agricultural marketing chain, or on the volatile world market.

With this system producers will be in the position where farmgate prices effectively have much less meaning as their profit concern will be the soybean crush margin, the price of ethanol, and the pork or beef slaughter margin made by their processing plants.

This was the overwhelming consensus of farm groups at our field events. It is one of the reasons we are having this hearing today and I hope we can gain a further understanding of how we in the government can nourish the entrepreneurial fire of current and future agricultural small business owners without impeding their success, by ensuring that the American agricultural system remains viable and becomes more profitable. We can re-grow rural America for generations to come.

I am very much looking forward to the witnesses. I want to of course, defer to my colleague, Ms. Velazquez, for any comments she may wish to make.

[Mr. Talent's statement may be found in the appendix.]

Ms. VELAZQUEZ. Thank you, Mr. Chairman, and good morning. Thank you for holding this hearing. I know how important this issue is for rural America. One of the benefits of being in the small business community is that our members come from such diverse backgrounds that we can truthfully say that we have experts in most fields: from regulations to access to capital, to agriculture.

Today, I have the pleasure of yielding to the gentleman from Illinois, Congressman Phelps, who also serves in the Committee of Agriculture and who has been working on this issue.

Mr. PHELPS. I want to thank the gentlelady for yielding and providing me this unique opportunity as a new member especially, and I thank the Chairman for holding this hearing and commend him on his leadership in this area. I greatly appreciate all of you being here this morning to discuss a topic which is particularly important to me as a member and not only of the Small Business Committee but also the Agriculture Committee.

I am pleased to be able to participate in a hearing that ties the two together so well. In my opinion, they are inseparable. Over the past few years America has experienced an unprecedented economic boom. Unfortunately, this prosperity has not been enjoyed by everyone. Many of our communities, especially those in agriculture, are in crisis.

My Congressional district covers 27 counties in Central and Southern Illinois. Every one of the communities I represent is deeply impacted when agriculture experiences tough times, and these are indeed some of the toughest in recent memory.

We are all well aware of what is happening in rural America. Rural America has not, not only shared in the good economic times but has possibly suffered more severely because of the crisis in agriculture. Many have regarded rural problems as being temporary when indeed, they are permanent.

Although it is clear that we must continue providing emergency relief to help our farmers survive the current crisis, this will not solve the underlying problems facing agriculture communities. This Congress should look to the future and support policies that help farmers help themselves.

One area that deserves our close attention is providing farmers with tools that will enable them to fully participate in the process of bringing to market the goods they produce. We all know that farming is inherently a risky business and enterprise.

Farm production levels can vary significantly from year to year, primarily because farmers operate at the mercy of nature and fluctuations in the marketplace. When commodity prices fall, as they have done in the past year, not only do producers suffer but consumers see no corresponding benefit. Shoppers continue to pay the high prices set by middlemen while our farmers begin to go out of business.

An obvious conclusion presents itself. We should help farmers take control not only of production but also of processing and marketing their own products, of course. An excellent model of exactly this kind of arrangement already exists: the farmer co-operative. Today, about 30 percent of farmer's products are marketed through co-ops, including some well-known brand names that can be found in supermarkets throughout the country.

Another way farmers can achieve stability is by finding new markets for their products and new products for their markets. Increasingly, farmers are beginning to look for new ways to process what they grow, thus creating new, value-added products to be sold in the new markets.

I look forward to hearing about some of these innovative strategies from our panelists this morning. Today's hearing will focus on the barriers that prevent many farmers from forming or joining cooperatives and how some of these might be removed.

In addition, we will discuss incentives and assistance that can be provided to spur innovation in processing and marketing. Our panel this morning includes representatives from producer and processing groups, members of the academic research community, and Department of Agriculture officials who will share with us how they are helping farmers with access to capital, technical assistance, education and research.

When rural America is struggling, an entire way of life is threatened. Our purpose today is to generate a discussion about what we can do to keep our heartland alive and help it grow and become even stronger.

I would again like to thank the Chairman for his leadership and sensitivity to this subject and ranking member for her recognizing the importance of this issue, and I look forward to hearing the testimony of our distinguished panelists. Thank you, and I yield back.

Chairman TALENT. I thank the gentleman and if our first panel of witnesses will come forward we will get going with the testimony.

And I am honored today to welcome my long-time friend, Charlie Kruse, to this hearing of the Small Business Committee. Charlie has a very impressive bio with a number of achievements. I think he probably just as soon be introduced as a row crop farmer from Dexter, Missouri. He is also president of the Missouri Farm Bureau.

Thank you for coming, Charlie, and why don't you share with us your thoughts on the opportunities of value-added agriculture.

STATEMENT OF CHARLES KRUSE, PRESIDENT, MISSOURI FARM BUREAU

Mr. KRUSE. Thank you, Mr. Chairman. I certainly want to commend you for holding this hearing. And to the members of the Committee, commend you all for taking time to talk about this very important issue.

As Chairman Talent said, my name is Charles Kruse. I am a fourth-generation farmer from Stoddard County, Missouri, in Southeast Missouri, where my family and I raise corn, soybeans, wheat and cotton. I serve as President of the Missouri Farm Bureau, our state's largest general farm organization.

Again, Chairman Talent, I want to commend you and the members of the Committee for your continued interest in empowering agricultural producers to take advantage of the benefits of adding values to the commodities we produce.

The Missouri Farm Bureau participated in both the field hearings that Chairman Talent mentioned were conducted last month, and we believe this Committee is determined to address the difficult issues we are facing. This morning's hearing is especially timely as Congress is debating how to assist farmers and ranchers during the economic crisis we are facing.

Let me assure you, this is indeed a crisis. The devastating combination of low prices and disastrous yield have come together at a very inopportune time. Corn and soybeans are being harvested in Missouri as we speak here today, and yields in many cases of less than 50 percent of average are all too common. And I am sure that is true in all the other states represented here.

In the short term we must have economic assistance from Congress. Farm Bureau's top priority is getting economic assistance to producers in a timely fashion. We simply cannot have a repeat of 1998. Assistance is needed now, not a year from now.

Economists at the Food and Agricultural Policy Research Institute at the University of Missouri are projecting that farm prices will improve over the 2001–2002 period. However, until that time we can expect dismal prices to continue. Our goal is to help farmers hang on and government assistance is crucial.

Yet, government cannot be expected to solve agriculture's woes alone. There is no simple solution. We must have a system of policies and programs that allows our agricultural sector to prosper. This will require the cooperation of every sector including public, private, and academia.

The purpose of this hearing, "Helping Agricultural Producers Re-Grow Rural America", is especially important. I have heard Chairman Talent highlight this issue during meetings in Missouri and we have heard the message loud and clear from our members.

We recently held a series of six regional meetings around the state in which we listened to our members' thoughts on how the crisis is affecting their family, their farms, and rural communities. A common theme emerged from the meetings: we must look for ways to capture a greater share of the consumer food dollar.

Some states are already doing a very good job of this. New generation co-operatives have been formed to process commodities into products ranging from pasta to ethanol. These states have made a commitment. Missouri too, is making a commitment.

Our Missouri General Assembly provided a boost earlier this year by creating new incentives for producer-owned ventures. This will indeed give us an important boost as our producers continue working to establish ethanol and pork producing plants in our state.

But there is a void remaining. While interest in these new ventures is growing, little attention has been paid to the availability of technical assistance. Producers and organizations alike need access to information that will convert an idea into an enterprise.

Where do we turn for product research, feasibility and marketing studies, legal assistance, and information on financing options? The information is available but it needs to be user-friendly.

Perhaps we should consider creating special teams comprised of representatives of state and federal agencies and colleges and universities. These teams could provide timely information on subjects ranging from financing options and environmental permits to tax incentives and equipment design. Ideally a "cook-book" could be developed that interested parties could use to help jump-start the process.

At the federal level, we have a unique opportunity to assist producers. Earlier this year, Farm Bureau supported and Congress appropriated, $145 million to the USDA's Section 32 Fund. These funds were appropriated to provide direct cash payments to hog producers who continue to suffer from extremely low prices.

Unfortunately, Secretary Glickman has announced that only $100 million will be paid in direct payments. If the remaining funds are not used for direct payments, we believe they should be used to fund programs that will encourage producers to add value to their products.

For example, these funds could be used to provide grants to groups to assist with start-up costs. We are encouraging USDA to work with agricultural organizations to develop the parameters of such a program.

In Missouri we have a group working to construct a new pork processing plant for independent producers. They could make good use of grant funds to assist with legal fees and other start-up costs.

Mr. Chairman, in closing let me reiterate that encouraging producers to add value to their products is a key to our long-term prosperity in agriculture. We believe there is a need to: (1) establish diverse teams or entities to focus on the needs of those considering value-added ventures; (2) develop a "cook-book" so to speak, that provides information on pertinent issues and available assistance; and (3) encourage USDA to use the remaining funds appropriated under Section 32 to develop programs to assist producers interested in adding value to their products.

Agriculture remains the anchor of our rural communities and our nation will continue to reap the benefits of this relationship well into the future if we can simply "tap into the vein" of value-added processing.

Thank you very much for this opportunity to testify, Mr. Chairman. I will be glad to answer any questions at the appropriate time.

[Mr. Kruse's statement may be found in the appendix.]

Chairman TALENT. Thank you, Charlie, and really appreciate your idea about using some of that money appropriated for the pork producers to assist in these value-added. Let us hope that Secretary Glickman looks favorably on that.

Next, another good friend, Dale Ludwig. I want to thank Dale for appearing before the Committee. He is the Executive Director and the CEO for the Missouri Soybean Association and the Missouri Soybean Merchandising Council. He also farms in Cape County in Southeast Missouri.

And during his tenure as Executive Director, the idea of value-added has become a major and an important one with the Soybean Association, and Dale has been a leader in proselytizing it around the country. Welcome, Dale.

Mr. LUDWIG. Thank you very much, Chairman, for this opportunity to share some ideas and comments. I will try to keep my comments brief but I would ask that my written testimony be included in the official record.

Chairman TALENT. Sure; without objection.

STATEMENT OF DALE LUDWIG, EXECUTIVE DIRECTOR/CEO, MISSOURI SOYBEAN ASSOCIATION

Mr. LUDWIG. As you said, I am Dale Ludwig. I serve as Executive Director of the Missouri Soybean Association, and Merchandizing Council representing soybean farmers in the state of Missouri. I also farm. I raise corn, soybeans and we have a livestock operation.

But the soybean farmers in Missouri certainly are—they are one of the greatest examples I think, of farmers trying to help themselves; as one of the groups I represent, the people that actually pay in check-off dollars to help develop technology.

I am proud of that group or both the groups that I work for, but especially that, because they are trying to help themselves. And we have actually been able to develop pieces of technology that farmers own, and I think that will be important when we take a look at some of the other opportunities that we have here.

I think Mr. Kruse did an outstanding job of kind of explaining how Missouri and all of agriculture are having some tough times and so I won't go into that, but would prefer to talk about, what are some of the opportunities that we see in agriculture, especially as it relates to value-added type things.

What we have done in our office is try to take a look at the things that actually have worked. What things have other companies done and what sort of commonalties if you will, can we put together that we believe are going to help some of these groups in agriculture be successful?

A couple of pretty basic things but, economies of scale is one. If you look at, you have to have a basic size component that is going to allow you to have the staying power and spread your fixed costs over a large number of units. But also, vertical integration seems to be one that many companies that have been successful, have gone into as well.

If we look at agriculture and some of the things that we have tried to do with generating additional volume, short-term it certainly is an answer to bring prices up somewhat, but if we look at the long-term opportunities for producers to actually capture more value out of agriculture, we are going to be able to have to do that in additional industries and not only count on, because of alternative uses we increase the overall value of a unit of that crop.

With that in mind, this whole vertical integration idea is something that we believe is extremely important. Let me give you a couple of examples of some things that are going on in Missouri, and not necessarily unique to Missouri.

In Northern Missouri we have a group of farmers that have gone together to look at the possibility of putting in a crushing facility for soybeans there; where we would produce protein and oil. As a result of that we allow those producers an additional market. We create additional demand in that area that pushes the price up. But maybe more important, and we believe more important, is they have an opportunity to capture additional value from that enterprise.

It is owned by farmers. It actually does the two things that we have talked about: economies of scale, because we pull all these people together; and the vertical integration.

Our next step in that vision is a number of other types of industries or businesses that too, would be potentially producer-owned. I talked about the technology earlier that was developed as a result of check-off dollars. It is owned by farmers, they could use it to generate additional small businesses that farmers would own along with neighbors perhaps, and even potentially, customers.

And we think that those additional steps, that vertical integration and additional opportunities to capture value, is what is going to make agriculture successful in connection with small business in rural America. Creating additional jobs for people outside of agriculture is part of the bigger picture that is going to make agriculture stronger long-term.

Short-term, again as Mr. Kruse said, there are some real issues that need to be addressed. But what we are trying to do is look longer term into the future and see what opportunities are going to be there.

But maybe the most important thing, the message that I want to leave with you today, is farmers are professionals. They have expertise in producing crops. But when it comes to technology and understanding technology and how to go into a business and be able to adjust some of the things that are going to make it successful, they don't have that expertise.

And maybe even more important is, business structures. We throw in some legal advice, but especially business structures. How do we work through a business arrangement as we have producers moving into areas that we haven't been in before? This is some of the expertise that we need to have and this is one of the things that you can do for us, so we hope that you will do that.

We can do that through grants; giving grants to form some of these self-help business groups and technology groups. But also the other part that I feel extremely strongly about is tax credits. And tax credits will help to put an infusion of cash into some of these new businesses that are going to help us to compete with larger producers. And long-term, if we are going to be successful we have to help them pay down that, and tax credits will allow us to do that.

I would be happy to answer any questions. Thank you.

[Mr. Ludwig's statement may be found in the appendix.]

Chairman TALENT. Thank you, Dale, and one of the reasons I want to have this hearing is, we know something on this Committee about starting new enterprises and how the government can assist in providing technological assistance to do that. So I was hopeful that we could focus the Committee's attention on that problem as it relates to rural America and maybe come up with some good ideas in cooperation with you.

Our next witness is Bruce Stockman from Minnesota. Bruce, I was under the understanding that there was going to be a substitute here for you today so I don't have your bio here. So I am going to let you introduce yourself as the Executive Director of the Minnesota Corn Grower's Association. It's good to have you here, Bruce.

STATEMENT OF BRUCE STOCKMAN, EXECUTIVE DIRECTOR, MINNESOTA CORN GROWERS ASSOCIATION

Mr. STOCKMAN. Thank you very much. I appreciate very much being here. Actually, I am a replacement and the reason why I am a replacement is, I work for farmers who are busy harvesting. And our President, Gerald Tumbleson, was to be here, and he is absent for that reason.

Mr. Chairman, I appreciate very much you and the Committee, the other panel members of this Small Business Committee for having this hearing today. It is extremely important in our opinion, that this subject be brought forward. There are many conversations that are occurring with pretty broad-based knowledge that agriculture is not enjoying what the rest of the economy has been.

And obviously, there are a number of reasons why that has taken place. Our concern is for the farmer. Some things we can control and some things we can't, and for those things that we can make an impact on, that is what we would like to work on.

The reason why I come here to you from Minnesota today, the Chairman asked on behalf of his staff and others, for someone from Minnesota to share some of the things that we have been doing.

I have been in Minnesota since 1990 as Executive Director. I came there from Missouri. I worked for the National Corn Growers and I originally grew up in Eastern Kansas as a farmer. And what we are trying to do in Minnesota builds on those experiences in that we over the past few years, have stimulated the creation of well over 100 closed co-ops.

You would say, well why do we need help if we have that many new ventures? What is the problem? The problem is as follows. In many cases, farmers have joined together, created these new-age co-ops, these closed co-ops, and in doing so they moved from one commodity to another.

They moved to ethanol and co-products, they moved to pork or dairy, or whatever the co-op is that they created. And what they found out is that there are some things they don't know about that new business. They found out that there are some resources that are difficult to obtain. There is no point central to find and access state, federal, foundation and other efforts that are all trying to help.

Twenty percent of our economy, and in our case in Minnesota it is actually greater than that, but at least 20 percent of our economy is based on the new dollars that are created by agriculture. Whether you are in the implement business or you are selling vehicles or you are the grocery store in town, if the farmers are hurting in rural America, so is the rural America economy.

And that is the case. I am sure that many of you have visited with many of those people. All of them are looking for solutions. One of the things that we found as a problem in creating the 11 farmer-owned ethanol plants and the many co-products that they produce, with 8,000 farm families invested in those, we have created a partnership with state and federal governments as incentives and farmer-owned dollars.

In moving to that new level of production we have created $200 million of additional demand for our corn in the form of ethanol annually, just in Minnesota alone. So what I am saying to you is that just creating a value-added by itself isn't enough. It has to have some extra value, something different. It has to have a niche in the marketplace. Something other than just be competitive at another commodity level.

I brought with me an example of something that yet can be. The diversity of what we have in the state is broad. This is a shirt that is not being made in that way. This is a fiber that is made from corn. I will share it if you want to pass it amongst the Committee members.

Chairman TALENT. Please do. Thank you.

Mr. STOCKMAN. The technology was developed in Minnesota; the production is occurring in Nebraska. It is made from Nebraska corn. And it is compostable and degradable. I suppose if it was flavored it would be edible, but it would actually be kind of bland.

Anyway, the purpose of——

Chairman TALENT. I suppose I can grill it or anything.

Mr. STOCKMAN. Yes, you could, if you would like a grilled shirt. The reason why I brought it as an example is, it is one of those opportunities that creates a niche. You will find that fabric like that is blended with cotton or wool or other fabrics and it adds value to those commodities as well.

Because that currently is being sold in the form of prills. They make it into like a polymer and it is shipped abroad and it is being made in Japan as we speak. Wouldn't each one of you like to have a production facility owned by the real community and farmers in your district producing that as a locally-owned product?

That is the kind of thing we are talking about; for medicines to all kinds of unique technology. The problem that we have is that we need a point central, a library, a resource center, consultants; some network. And as Charlie put it, a cook-book. We need a mechanism to bring this point central to help facilitate the resources that are there.

We need the encouragement of producers and for them to be the self-help they can be. This is a long-term fix; it's not short-term. And so the other things that are being worked on for short-term we also want to encourage.

But this is something to invest in our future. And our whole society depends on it because corn and other commodities are not just food. They are food, fiber and fuel. Thank you.

[Mr. Stockman's statement may be found in the appendix.]

Chairman TALENT. I am going to be interested in the question time in asking in greater detail what you mean by point central. So please be thinking about it.

Our final witness on this panel is Mr. Jeff Ward. He is the Director of Producer Education for the National Pork Producers located in Des Moines. Jeff has had a lot of experience in the banking industry. I also understand he is a graduate of the University of Missouri at Columbia, which is a fine university.

Jeff's responsibilities at National Pork include issues relating to the environment, genetic improvement, animal care and value-added marketing. Jeff, thanks for being here and please share with us your thoughts about value-added opportunities.

STATEMENT OF JEFF WARD, DIRECTOR, PORK PRODUCER EDUCATION, NATIONAL PORK PRODUCERS COUNCIL

Mr. WARD. Thank you, Chairman Talent. It is a pleasure to be here today. As you said, I am Director of Producer Education at the National Pork Producer Council and due to various economic factors over these past couple of years I have spent a great deal of time studying how you put value-added groups together and assisting groups in doing that.

As most of you know, live hog prices in December last year dropped below ten dollars a hundred-weight for the first time since '55. When you adjust that for inflation, those were the lowest prices than even we had in the Depression. So we obviously had a crisis that needs to be addressed.

The University of Missouri estimates that the producer sector lost $2.6 billion in equity in '98 and another one billion in equity drained to the industry in 1999. So as we look at this there is definitely a need for producers to be able to take advantage of the pork marketing chain.

And 1998 also saw producers received their smallest percentage of consumer dollars in history. We had an increased supply of market hogs with a reduced slaughter capacity system that created an economic disaster. This happened however, during a record year for pork consumption and in some cases, pork retain prices.

As this unfolded it became very evident that the dollars in the pork chain were at or near the consumer. So my job over the past couple of years has been, how do we get producers closer to that consumer?

One example that I will give as we go through this, and I was really kind of given three questions on the e-mail I got about this meeting, and the first one was, can producers do this? And I believe yes, they can.

In 1997 we had Dennis DiPietre at the University of Missouri and Brian Buhr at Minnesota do a study for us to determine if there were unmet or underserved pockets of demand. We heard about niche markets in the previous speakers, and were there market niches that producers could slot themselves into that would allow them to get closer to that customer?

The goal of the study was to determine if there were differentiated pork preferences among ethnic groups and if so, how do producers identify and capture those preferences? The results of that study are in a book that is way too big to read to you today but we can get a copy of that to you if you would like to see it.

But the study quite conclusively showed that—well if I can back up a moment. As we studied this we picked the Hispanic consumer in the United States to look at and it showed quite conclusively that there were cut preferences, different carcass breaks that were not found in the current commodity market.

And that there was also, when we did the economic work, a willingness by those consumers to purchase additional quantities of pork if it was provided to them in a way that they preferred. The study did provide a very direct insight into that market. But more importantly we put this together in an educational format; if there were other pork chains out there where producers could slot themselves into if they were not in an ethnically diverse area.

As a result of that study a group of smaller, independent pork producers in Utah went together to attempt to access this market. And if you are familiar with Utah demographics I don't think you can call it really an ethnically diverse state by any means.

But they started out with the proverbial seven pigs in the back of a pickup one Saturday and delivered them to a market. They are now marketing 44,000 head per year to these ethnic markets in the Salt Lake Valley. So when I am asked if I think it can be done, yes it can. It just takes an entrepreneurial spirit to pull this off.

The second issue that I was asked to address was: what are the barriers to creation of these? And they have already pretty well been alluded to with the previous speakers. But as I work with producer groups the first barrier seems to be a lack of knowledge or resources when you start talking about market access and market discovery issues.

There are various resources out there. Some of those are cost prohibitive without some kind of assistance. We also have some out there that are very self-serving and not looking out for the producers' best interests. So any assistance, and I will get to that in a moment, but any cost-share kinds of things would be very beneficial in that area to help provide technical assistance.

We had, as Mr. Kruse mentioned earlier, put together what we are calling some technical assistance teams to help producers, but the sheer magnitude of that project is going to prevent us at this time to get to everybody that certainly needs help.

The second area that we see, and has already been mentioned, is the lack of access to capital for start-up and operations. As you look at these, a lot of the conventional sources of capital that producers have used in the past are not familiar with these kinds of ventures; therefore they are requiring high equity input by producers to come into these things. They are requiring loan guarantees.

So one of the solutions to this, I guess I would encourage as you are working through this, that the loan guarantee process be made much more user-friendly and available to producers to work through.

Finally I guess, and the third question in this was, what programs are needed to encourage? And I am going to just kind of echo what the rest of the group has said. But in addition to the financial and technical assistance, I believe it also needs to be in an educational format so we don't continually re-invent the wheel.

You have already seen here, we have Farm Bureau doing something, we have Corn Growers doing something, we have soybean people doing something. There are all these factions out here that doing something and in some cases we are all just re-inventing the wheel. And so I think it also needs to be an educational process where duplication of efforts can be reduced.

I think assistance in the area of business planning and marketing plans and feasibility studies are very important. We recently did some case studies on three producer groups that have successfully added into value-added marketing opportunities.

And I guess really to our surprise as we worked through those, they all had a very well thought-out, well written and a business plan that they did follow on a day-to-day basis. And they all felt that that was very key to their success.

Finally I guess, most of you are familiar that in June, National Pork Producers announced the formation of a national co-op to explore further processing activities for pork producers. I think that is one umbrella that some of this could come under because it will allow other groups to attach to it and avoid that duplication of effort that I talked about earlier.

Finally, I believe by providing easier and increased access to loans, grants and loan guarantees for feasibility and start-up and operations, I believe will allow producers to have an opportunity to determine their future in the pork industry.

Thank you.

[Mr. Ward's statement may be found in the appendix.]

Chairman TALENT. Thank you, Mr. Ward, and all the witnesses. I have a few questions and then I will recognize the Committee members.

Mr. Ward, you talked first about niche marketing and I understand the relationship between that and value-added in the sense that you are talking about both require a market-driven kind of model. In other words, you have to be thinking in terms of not what you are going to produce but what consumers want, and then tailor your production to that.

How else does that niche marketing though, relate to value-added? In other words, you don't necessarily need for producers to invest in processing or slaughterhouse to do the niche marketing, do you?

Mr. WARD. No. In fact, the Utah group that I alluded to, they recently started out doing a custom, total slaughter arrangement with two small slaughter facilities in Northern Utah.

Now, they do now own their own slaughter facility but I think a key to that—and they were one of the case studies we did—was the market dictated their growth into owning a slaughter facility. They didn't do the, build it and they will come sort of philosophy. And I think the model that they put together there was a real key one in their success.

Chairman TALENT. The mindset is the same, in developing either value-added or niche marketing?

Mr. WARD. Right.

Chairman TALENT. You have to think of yourself not as a producer so much but as somebody who has got to figure out that market and then produce what they want. To think in a broader sense, as a business person, in other words.

Mr. WARD. Exactly. And what they are doing, they are not necessarily extracting any more value out of that customer; i.e., a pork chop selling for $2.30 instead of two dollars a pound. But they are tying up more steps in that process getting to that consumer.

And the other thing, they are close enough to the consumer that they are able to visit with them on a day-to-day basis and have direct feedback with what those customers want instead of having to come through these various layers.

And one of the things that you will see there in the paper is, in this market-driven model that especially exists in the pork industry, there is very little information sharing from the consumer to the retailer to the packer/processor, down to the producer. And so the closer you are able to get to that then the better knowledge you have of that consumer and the quicker and the faster you can supply that product to them.

Chairman TALENT. Let me address the other question to the panel as a whole, because I am sure other members of the Committee felt the same thing when they were listening.

When you all are talking about starting new enterprises whereby entrepreneurs who are aggressive but need help with technical assistance, making sure they know what they are doing and then some seed money to start up, I mean, you are talking about things that the Small Business Committee is very familiar with in a number of different contexts.

So I would like to ask you all to try and address more specifically, how you think we can best help get you that kind of technical assistance that you need. What kind of a program or incentive? How we can do that in the ag market to help you the best. And is there a model out there that you particularly like? Maybe in Minnesota which seems to have gotten further in this area.

Bruce, is there a model for government assisting? For example, we have a program called SBCD, Small Business Development Corporation. You guys are familiar with this in another context. They provide assistance to entrepreneurs either with start-up or expansion-type operations.

Would it be good to vest them with some particular portfolio in this area? Do we need a separate type centers, ag innovation centers? Give me some ideas on that.

Mr. STOCKMAN. Mr. Chairman.

Chairman TALENT. Yes; anybody on the panel.

Mr. STOCKMAN. I would like to answer that. Exactly what you have suggested is what I was referring to when I said point central. I apologize for not explaining it further. That is in fact, the problem that we had in Minnesota, and I assume elsewhere. Is that there is no one place that can pull these resources together or advise where to find those resources.

Whether it is the Small Business Development Center or an innovative center, there needs to be a point central; a focus point that can locate, be the library, find the consultant or at least recommend consultants, suggest both state and federal as well as private resources that are available.

There are a number of tools that are available but there is no coordination of those tools at this point, and that is really what I'm asking for; is a center or something like that.

Chairman TALENT. Does anybody else want to comment on that?

Mr. LUDWIG. Real quickly. I think that what Bruce was talking about is very much kind of what our vision was of having a center that, although we talk about agriculture it's more likely to be someone who would have engineering expertise that would be able to help guide and direct, through general projects and then identify some of those specialists as a result of specialty needs.

At this point in time I am not sure we can even venture to guess what some of those needs are going to be long term. So I think it was very close to what our vision was.

Chairman TALENT. Dale, tell me why you think—I mean, I agree with you but I'm going to play devil's advocate for a second here. Why do you think that soybean producers can compete with ADM and Cargill in the crushing business?

Mr. LUDWIG. Well, you know, that is a great question and it is one that I have spent a great deal of time giving thought to. And part of the answer is not even a great one but part of the answer is that if we don't figure out how to do that our future isn't very bright.

But the reason I believe we can is kind of twofold. And that is part of the reason that I ended up my testimony saying, here are a couple of areas that you can help and the tax credit one I think, is one that is critical. You may have a better idea. You understand how tax credits work better than I do and you may even have some other areas how you do that.

But we have to help level the playing field, or in my opinion, even tilt it towards these producers to put a larger percentage of cash equity in that facility so that long-term they have some of that staying power.

The other thing that is very, very important is when you talk about—I don't know if niche market is the right word—but in an area where they have a much better opportunity to survive. And that means you do a feasibility study, you do a business plan, you go into areas where you are not going to compete head-to-head with an ADM.

Quite honestly, I would not look forward to doing that as a producer group. So you go to an area where you don't have to do that.

Chairman TALENT. One more question for Charlie. If we were to get the Secretary to redirect the $45 million in pork producer's amount, how would you recommend that we invest that to have the greatest impact on value-added?

Mr. KRUSE. As I said in my testimony, Mr. Chairman, we had hoped that that money was going to be directed to hog farmers for direct assistance but it appears that is not the case. So given that, I think market feasibility studies, technical assistance. And I think the common thread on this panel, everybody on this panel has talked about the desire on the part of producers to get involved in these kinds of activities.

I think there is a real eagerness, if you will, on the part of producers today, to really get involved in some kind of value-added project. And it is not one of these situations where we as farmers are saying government take our hand and walk us through this. That is not it at all.

Farmers are willing to share in the risk, share in the investment. We just need some help in bringing together technical assistance, expertise, market feasibility studies; sort of a how-to. That is why I mentioned in my testimony about perhaps having some kind of a cook-book that we can work through together.

But hopefully we can encourage the Secretary to direct these dollars that way because I know you all in this Committee have been very active in doing this in other sectors of the economy. I think agriculture is in a situation now where we really need to do all that we can to help farmers get involved in adding value.

And Mr. Chairman, as you said in your opening comments, to get farmers to the point of being directly involved in the vertical integration that is taking place. I think that is a very good point.

Chairman TALENT. All right, thank you. I will recognize Mr. Phelps.

Mr. PHELPS. Thank you, Mr. Chairman. Thank you all for your testimony. It is very beneficial to us. Just real quickly, I think you all have alluded to technical assistance item and the Chairman covered that very much thinking that small business centers would be a viable focal point to possibly work from.

Just for those of you, maybe Mr. Ludwig, it seems like that the soybean community has been a leader possibly because of the ethanol that has been a product that has proven to show you can diversify agriculture.

And maybe you have mentioned some of these but from the priority list, one or two, what would be some of the lessons that you have learned for trying to form co-ops and getting the job done as you have in this particular area where soybeans and ethanol has taken off, that you could give to the ag community who might be looking to form a co-op? Are there particular barriers to avoid, are there some prime target things? Steps 1 and 2 that you would recommend? Because your leadership in the soybean area has been commendable.

Mr. LUDWIG. Well, you know, that is a great question and I appreciate you asking it. What I would like to do is just share some of our experiences. Actually, in Minnesota they have had much more experience with actually putting those groups together.

You know, I think that there are a couple of things that we have tried to do, especially with soybean research. And a couple of those things are, you hear a lot of people talking these days about environmental benefits, you talk about how things that are renewable, all those things are fantastic.

And we believe that they are but one of the things that we have learned is that as we take a look at this research and then try to move it into some sort of business structure that people appreciate the fact that it is environmentally friendly, that it is renewable, that it is biodegradable, provided it costs less than the current product that is in the market.

So bottom line, you have to deliver either additional value, a better product, or you then have to be able to deliver that product to the current market at a lower price than what you had.

But the second part of your question is, what are some of the pitfalls? You know, and Bruce actually might be in a better position because they have more co-ops there in Minnesota than what we have in Missouri.

Mr. PHELPS. We just need to recognize success stories and build on that and avoid the problems that you may have faced, because you have the leadership in this area.

Mr. LUDWIG. Right.

Mr. PHELPS. Can you add to that, Mr. Stockman, from a Minnesota perspective?

Mr. STOCKMAN. Mr. Phelps, thank you for asking. I will try. In effect, several of the groups experienced what their predecessor did. Whether it is how to come together as independent farmers and function as a Board; how to make policy decisions and stay out of the management; how to decide and come up with a strategic plan; where to go for resources; how to find those services that are currently offered and where do I go to find them.

All of that are the kinds of thing that I have seen almost every one of these organizations as they come together, repeat in some way. And so it seems to me that an innovative center or a center of some sort could provide that how-to, that cook-book, that list, even serving as advisors in some cases themselves directly, on whether or not they've got their stuff together ready to take the next step or whether they need to go back and start over.

Some of them have started with their feet running and really didn't know where they were going. And so there are all those kinds of problems to get focused first.

I think another thing that has happened is that in many cases they really say, I want to diversify and own something further up the chain but it just moves them to a different level they didn't anticipate. They need to know what else, where else, how else.

Mr. PHELPS. Thank you very much. Just one last question, Mr. Chairman. Mr. Ward, in your testimony you alluded to the problems that led to our disaster in the pork industry. An increased supply of market hogs combined with a reduced slaughter capacity created this situation for producers, and also, even though there is a record high year for pork consumption.

And I guess my question is, why do we not have those indicators far enough ahead to try to get organized to avoid at least some of that, if not most of it? Did it come that quickly? I mean, usually we have warnings even of hurricanes, but it seems like we ought to have some experience somewhere in the industry saying that the vertical integration such as the poultry industry experience, this is coming down the pike. We had better get ready for it.

Mr. WARD. Sure. Very good question and certainly one that we have had to answer before. And there were obviously, very strong indicators that we were going to be up in production about ten percent in '98. The proverbial straw that broke the camel's back I guess, was the plant in Detroit that closed last summer.

The system was going to be loaded and prices were going to be down but not to the level they went. You could see that coming.

And then when we lost that 12,000 or 14,000 head a day capacity out of that Detroit plant last summer that was literally the straw that broke the camel's back and ultimately caused it to drop where it did.

We were probably, and I don't have those numbers in front of me, but I believe mid-20s to low-30s were what most of the economists were predicting for that incident.

Mr. PHELPS. So we have two extra-large processing elements that are critical to the whole process?

Mr. WARD. Exactly, and one of the things as we are looking at this, and we have announced this national co-op to explore potentially building some plants to address some of that issue, but you have this and you have producers that are in charge of these situations through closed co-ops or whatever it is, is one way of somewhat addressing that concentration issue because you are putting producers back in control of their own destiny and getting them ultimately closer to that consumer.

Mr. PHELPS. Thank you. I yield back, Mr. Chairman.

Mr. BARTLETT [presiding]. Thank you very much. Let me at this time recognize Mr. Thune.

Mr. THUNE. Thank you, Mr. Chairman. I will pass for the moment and reserve my questions for the second panel.

Mr. BARTLETT. Thank you very much. Let me now recognize Ms. Christian-Christensen.

Ms. CHRISTIAN-CHRISTENSEN. Thank you, Mr. Chairman, and I want to take this opportunity to thank our Chairman and ranking member for calling this important hearing on how we can help agriculture re-growth in America.

I am the ranking member on the Subcommittee on Rural Business Enterprise and Agri-Business, and my colleagues and I on that Subcommittee take a special interest in this subject.

Even based on my own experience in a place that is not very agricultural, the Virgin Islands, I hear the same issues raised and so I agree with what I have heard all of the panelists say; that the farmers are the experts but what they need is assistance with technology with business expertise, and with looking for those niches that can make their businesses successful.

We have had good experience with the business and co-operative services at USDA, and I was wondering, and I direct this question to Mr. Stockman but anyone else can answer, again on the one-stop center of expertise, the resource center.

What about the Rural Business and Co-operative Service at USDA and what services are they providing that meet your needs and what do you think that they could add to their services? Are they a good source of that information; those resources?

Mr. STOCKMAN. I apologize for not being able to expound on that. I guess that is part of the problem, is that the awareness of what is available is part of this problem. And that is why a center or something like that would bring those resources to better use.

I appreciate you asking that question. I am answering in this way so you understand that that is part of the problem. It is not that they are not functioning and I am not pointing fingers. I am just saying that there is no way oftentimes to find where those resources are in an effective manner.

Ms. CHRISTIAN-CHRISTENSEN. And we have been discussing possibly holding a hearing just with that Department and rural development to discuss some of those issues on our Subcommittee. Did anyone else want to answer that?

I don't have any other questions for this panel, Mr. Chairman. Thank you.

Mr. BARTLETT. Thank you very much. To maintain the rotation to the two sides of the aisle, let me ask a couple of questions now.

You have been talking about two different things: vertical integration and niche marketing. These are of course, two different things although they could be combined. Recently as everybody knows, we have had large disparities between the consistency of pricing of milk at the farm and pricing in the store.

Our dairymen were getting as much as $18 a—I say as much as; that is really very low if you had indexed it—getting as much as $18 per 100 for milk on the farm. And then it has now dropped down to about $12 per 100. And in the store there was not a ripple.

This obviously begs for vertical integration. What happened to that six dollars per hundred? The farmers didn't see it and the consumer didn't see it. It certainly didn't drop in the store. So that obviously begs for vertical integration.

We will pause for a moment while the beepers tell us that there are a series of votes on, which is what those bells mean.

I am particularly interested in your comments about alternative uses. I was reminded of that this summer when we had a severe drought in our area. Our pastures dried up on our farm. And I bought barley for less than $80 a ton.

Hay would have cost me a whole lot more than $80 a ton and barley is a whole lot easier to haul and handle than hay is, so I simply bought barley and saved the hay for winter feeding; which was for farming, an alternative use of barley as a substitute for hay.

Two years ago I bought corn for about $80 a ton. Last year it was about a bit under $100 a ton I guess, and it is going to be what, closer to $80 a ton this year. If you look at corn at $80 a ton, and if you look at cord wood for your stove for your fireplace at $100 a cord, there is a whole lot more energy in that ton of corn than there is in that cord of wood.

And if you are looking at pellet stoves, and corn comes already pelletized, you are talking about $120 a ton at a minimum for pellets. Corn is a whole lot cheaper than that and I suspect has more energy than that.

I go to dinners put on by farmers and they don't offer me milk as a drink. Well, they do now in our district because I have been yelling about it. But ordinarily there wasn't milk there as a drink.

My question is, what sort of energy are we putting in to finding alternatives uses? I would like to see milk in vending machines. It is not just a drink. It is a very high quality food. There isn't any reason that we can't make it attractive to those who frequent vending machines, and milk ought to be there.

And by the way, you can pay almost as much for water as you can for milk. And you pay a whole lot more for coca-cola than you do for milk. What sort of energies as an industry are we putting into looking for alternative uses for our products?

I saw the shirt with great interest that you had made from corn fiber. That is an interesting alternative use. What sort of energies are we putting in? And is there a concerted effort to find these alternative uses in niche markets?

Mr. LUDWIG. At the Missouri Soybean Association, we actually have a national check-off; that we put nearly a million dollars a year that go into research for alternative uses.

And part of that includes, I think, some of the most exciting at this point in time, or even developing soy oils or identifying soil oils that can be used for industrial purposes, and taking a look at all the different things that we can potentially do beyond what we have considered normal or regular, conventional uses for soy oil.

We have done some of the same things with protein but the protein seems to be a little tougher to identify, at least in conventional soy beans. But there is no shortage of effort that goes into that, and certainly, you know, again I think that we need to recognize farmers for farmers actually taking their dollars and putting dollars into research that has the opportunity to affect or direct their future.

And there is no question that in our industry it is a great deal of effort is going into those areas.

Mr. BARTLETT. Mr. Stockman.

Mr. STOCKMAN. I would love to comment on that. It is true with most of the commodities, and corn in particular, there is well over 3500 different kinds of products currently available to be made from corn alone.

I went to a general discount store recently with a manager who I knew, and I asked, would you do a project with us? And the idea of the project was a contest for their customers, but the idea was, they had a form to fill out of how many things in that general type of a store were made utilizing corn in one way or another.

And after they got to about 75 percent of the products in the store they quit. They said, enough. They literally were putting these marks on the shelves of everything practically, with the exception of steel or rubber. And in some cases they can make a rubber type of material. But their rubber was not.

The point is, there is a lot of technology on the shelf ready to pull off. The missing link is how to match that opportunity of something with the opportunity in the marketplace. The marrying of the idea along with the need is the missing link, and that is where these centers I believe, could help.

Mr. BARTLETT. Thank you very much. As you have heard, several bells have gone off. We have a series of votes, I gather. This might be a good time to break for votes and we will return as soon as we can.

If there is just a single vote it will be in 15 minutes or so. If it is a series of votes the second vote and a third if there is one, will not be more than five minutes each. So it shouldn't be too long until we return. We will stand in recess until the end of the vote.

[Recess.]

Mr. BARTLETT. Thank you very much. We want to make sure that there are no members who wish to ask questions of this panel who have not yet had a chance to return from the vote. So if we can occupy for a few moments until we see if there are any of those who will return, then we will be able to excuse this panel and convene the second panel.

The Chairman promises to return and to be with us in a few minutes. I hope that is true because I need to leave in a few minutes.

Let me return to the subjects that we were discussing before the break for a vote and that is the opportunities for niche marketing, for diversification.

It is clear that we need both vertical integration and niche marketing. And my concern is that this is a role in the diversification which could very well be niche marketing. But is there a role there for government? Generally, I see government trying to play too much of a role.

And my concern is that I am not sure that government at either the state level and particularly the federal level, is stepping up to the opportunity of providing a structure in which our agricultural people can look at not only vertical integration but also diversification and niche marketing.

And I am wondering if you have some suggestions as to what we might do; appropriate legislation that would help us to use the relatively few dollars that we have to help farmers to be more productive in opening up future opportunities for them by looking at other opportunities for diversification and niche marketing.

Mr. Ludwig.

Mr. LUDWIG. Well, again to paraphrase real quickly what Mr. Stockman said earlier, I think we have done a great job at developing technology, and maybe the missing links are the technology expertise and actually then molding that technology into real products. And that is the thing we have to move forward on; is turning these things into real products, into real businesses.

And I think that one of the things that is going to help that the most—and I mentioned tax credits before. And I think that is an excellent way to infuse some capital into some of these things. You have a commitment on the side of those people who are going to be involved, and then you incentivize them for doing that.

And that is part of the reason that I keep talking about that side of the equation. I think in some cases we have more government than we need, but in this particular case we are taking people that are truly interested in doing it, because they are willing to put their dollars into it, and then we incentivize them on the other side for having done that.

Mr. BARTLETT. Anyone else have a comment?

Mr. STOCKMAN. I guess I would add to that, the shirt that I used as an example before I will use as an example one more time. Right now that is being utilized by private industry. Part of the research for the polylactic acid was partnered with organizations such as ours, and in Missouri and other places.

There have been several different technologies that have come from that. One, a company specialized in themselves and in developing it further now are developing markets accordingly. There is no reason why government couldn't assist farmers capturing those opportunities rather than just let those who happen to have the capital ready to do it.

So both division and capturing that opportunity, and then also linking it to the producer and the consumer.

Mr. BARTLETT. Looking at that shirt I was reminded of a marketing opportunity that we are missing. When our dairymen got into trouble recently I was amazed—now a very small percent of the people in our district are dairymen—but I was amazed at the enormous support that dairymen have. And it is because almost everybody can remember visiting their grandfather's farm.

And although very few of our people live on farms today they have a great nostalgia for the family farm. And Americans want to support the family farm. And if that shirt were in the store and it cost a little bit more than one made in China but it was advertised as a product of American farmers made from corn, I think that you would have a lot of people paying the few pennies more for that shirt as compared to the shirt that is made in Taiwan or Korea or China.

I think we are missing a marketing opportunity because I think America is 100 percent behind the family farm and I think that we need to exploit that in our advertising.

Mr. STOCKMAN. I applaud you. We agree wholeheartedly. And pulling that together will make a difference.

Mr. LUDWIG. I also believe that, you know, people in general have a good, warm feeling about family farms, but maybe the point that they don't understand is that the more people that we can keep involved in production agriculture and the more competition there is there, the better there is for consumers long-term as well.

It is something that truly is good for the average person in this country, average consumer, that oftentimes they probably don't recognize. But if we are successful at developing some of these new businesses and are able to bring new products, in many cases better products, products that are indeed, more friendly to the environment, there are many benefits there that oftentimes we don't think about, and maybe we in one way or another need to do a better job at just communicating with them.

Mr. WARD. Yes, I would agree with that. We have a group in Iowa right now, a producer group that has gone together and are doing some packaged, pre-cooked, different kinds of products. And they have been very successful. Now obviously, they do have a differentiated product which has given them an advantage, but it is so-and-so county family farm-something on the label.

And I guess I thought they would succeed because they put their plan together right but I have been real pleased with the growth and the way they have been able to market that product and get it on store shelves and then ultimately having the consumers buy it. So I would agree with that.

Mr. BARTLETT. Thank you very much. There is another dynamic in this support for the American farmer that I think that we can exploit to the advantage of agriculture.

I think that a lot of our people are supporting the family farm because they recognize that this is a part of our heritage; that when we have lost that we have lost something. I think they recognize that the young men and women that came off our farms were kind of a breed apart from what comes out of suburbia and the cities today. And I think there is a lot of nostalgia, there is a lot of concern that we are losing something in America if we lose the family farm.

So I think that we can exploit the broad support for the family farmer across America in getting a bigger market for many of these alternative products—you know, they are used to buying soybean oil and they are used to buying bread.

But if they are now buying a shirt which is made from corn fiber and if they are now putting soybean oil in their diesel car, which I understand is quite doable with a modest modification, I think we are going to find big support for the American farmer.

I am on the National Security—it used to be the National Security Committee; now it is the Armed Services Committee. I have an additional interest in agriculture in this country and that is from a national security viewpoint.

You know, I am concerned that we are now importing much of our manufactured goods. You know, we don't need to be importing food and fiber that we can grow on our farms, and if we keep going the way we are we will be importing more and more of that and I think ultimately it is a national security concern.

We have held this panel for a few moments to see if there are additional questions. Ms. Millender-McDonald, do you have questions for this panel before we excuse them and reconvene the next one?

Ms. MILLENDER-MCDONALD. Well, thank you so much, Mr. Chairman. I too, am very pleased to have the agriculture industry to come before us, members of that industry. Those of us who are in the urban and suburban side of this country tend to look now at agriculture, or this member does, because I see the importance of you more so than ever before; certainly as I sit representing the two ports that make up the largest port system in the nation: the ports of Los Angeles and Long Beach.

And it is important that we look at the empowering of you to further do value-added commodities. And so I perhaps, Mr. Chairman, there were some questions that I wanted to raise but wanted to more or less thank the Chairman for bringing this information or this group to us because of the importance of agriculture.

And those of us who sit in the House who are urban and suburban, need to get more information on this so we thank you for being here. And don't think because we are in and out and have not been here, we are not reading your script, because we have it.

I guess one of my questions is, what agriculture commodities are best suited for these value-added businesses? That is a question that may have been asked but I just need to know that. Either one of you can answer.

Mr. WARD. I think probably all commodities can take advantage of that and you know, when you think of pigs, when you think of pork, you think of the products sitting there on the shelf in the grocery store, but currently the highest value per pound pork product are these dried ears for dog chews. So you know, there are I think opportunities in every commodity area.

Mr. LUDWIG. I think specifically here today there have been, you know, a couple of the commodities that are represented are some of the most important in the country if you look at what our largest commodities are.

On the crop side it is obviously corn and soybeans and then livestock, pork, poultry, beef and dairy. And so those are the ones that have the critical mass; the number of producers that are going to be able to supply it at a lot larger scale if we have to if we are outrageously successful and can go to that.

But just an example of how we don't necessarily—we cross a bunch of different industries as we talk about value-added. One of the things that we do in Missouri is grow soybeans that go into the food bean market that go to Japan and they are loaded out in Long Beach. They go through that port from Long Beach. And so it is interesting how we actually affect, not just agriculture but rural development as well as some of the largest industries in the country.

Ms. MILLENDER-MCDONALD. Absolutely.

Mr. STOCKMAN. Anything made from petroleum can be made from, if you will, biomass; all these crops, corn included. It seems to me that the greatest opportunity comes from those with the most abundance.

If in fact, something was very scarce—gold, something like that—the abundance is lacking so the creativity and the need for expanding value is not the same as it would be for something that's very plentiful. And so those things that are more plentiful and less expensive really create the greatest opportunity, and our commodities right now are all in that shape.

Ms. MILLENDER-MCDONALD. How many of these value-added businesses can we look to in exporting to other countries for our percentage of exportation to other countries? Or can any of these value-added businesses be as a future, an exportation type of commodity to other countries?

Mr. STOCKMAN. There are several things that are happening quite frequently and that is, identity preserved in several different ways. But our desire is not just to capture that. Our desire is to create the jobs that make something special out of it first before it is exported, rather than as a commodity or even an identity preserved commodity.

We think the opportunity for our economy and our country is much greater to create those jobs right here first. Because of what has happened in agriculture, the tradition has been shipping the raw production because farmers are experts at producing. With the technology and a whole lot of things, the volume of our commodities has grown quite rapidly.

But that is only part of the story. In fact, by giving it away or selling it at a basic commodity price you have given away the biggest part of the opportunity because the margin in a box of cereal goes from a few cents to several dollars, and that is where the margin is.

Ms. MILLENDER-MCDONALD. I couldn't agree with you more that we certainly should make ready jobs in this country for purposes of our economic growth. But clearly, as I talk to other agriculture folks that come through my district, being that I am representing the ports, I am interested in international trade in agriculture.

I would like to see that growth market go across the seaways and the airways as well. And so I will further listen to the other panelists but do recognize the importance of your industry, even though I represent the urban and suburban.

Thank you, Mr. Chairman.

Mr. BARTLETT. Thank you very much. I caution people not to criticize our farmers and our farm programs with a mouthful. I can remember as a boy that it was a general rule of thumb that 25 percent of your budget went for food. Today that is down to about ten percent.

A few Americans know that and understand it and really appreciate farmers. It is our challenge to let every American know that so that they will appreciate farmers even more, because farmers have freed up a full 15 percent of income for other spending. They don't have to spend it on food because the farmers are producing food so efficiently that the share of the family budget that used to be 25 percent for food is now down to ten percent.

We are just missing I think, a lot of marketing opportunities to sell farming. And it is not a tough sell by the way, to sell farmers and farming to the American public.

Well, I want to thank the——

Ms. MILLENDER-MCDONALD. Mr. Chairman, can I just——

Chairman TALENT. Go ahead.

Ms. MILLENDER-MCDONALD. Let me concur with what you are saying. We don't see enough of the farmers in other areas of the country other than in your rural areas. And so when you get out and start doing your marketing across other districts can we better appreciate.

Now we all eat your food and we certainly enjoy and appreciate what you are doing. But to really get to the crux of how this is done we need to have more interchange. And so I welcome any agriculture member to come to my district, even you, Mr. Chairman, to talk about that.

Mr. BARTLETT. Thank you very much. Thank you very much. I want to thank this panel. By the way, you don't see the farmers because they are working 16 hours a day; that is why you don't see them.

I want to thank this panel very much for their contribution. We will excuse you and convene the second panel.

[Recess.]

Mr. THUNE [presiding]. We will reconvene. I am pleased to have the second panel with us today and I would like to start by introducing Dr. Virgil Flanigan. I thought I might need a rocket scientist to explain some of the opportunities of value-added agriculture so the Chairman did invite Dr. Flanigan to enlighten us a little bit on that.

Early-on his career he was on the design team for both the Saturn delivery vehicle and the Sidewinder missile, so he really is a real rocket scientist. And over the past years Dr. Flanigan has developed and headed one of the most successful and visionary crop utilization and processing research programs in the nation at the University of Missouri-Rolla, which has focused on new uses for soybeans.

So Dr. Flanigan, please share with the Committee your vision of where producer-owned, value-added agriculture can take our agricultural system, and then we will move on with the panel from there.

STATEMENT OF VIRGIL FLANIGAN, DIRECTOR, CENTER FOR ENVIRONMENTAL SCIENCE AND TECHNOLOGY, UNIVERSITY OF MISSOURI-ROLLA

Dr. FLANIGAN. Thank you, Mr. Chairman. Just a little bit of my present position. I am the Director of the Center for Environmental Science and Technology at the University of Missouri-Rolla, but I have been involved for the last 40 years in looking at agricultural products and trying to use them as a, typically as an energy product.

And we have always had the problem when we do this of trying to get good economics. We always had a renewable, environmental-friendly, and biodegradable product but we always had the difficulty with economics. We always had to pay more money as compared to the alternate fuel.

So that always was something we had difficulty with. But in the last five years I have started working with products, especially oils from our commodities, and all of a sudden we begin to see economic opportunity as well as opportunity based on biodegradable, renewable and environmentally-friendly.

And it is amazing the products. You know, just looking in our little operations, we are looking at making a product for jet airplanes, we are looking at making a product for recycling polystyrene which is a huge problem all over the world, and we are looking at building houses in Honduras, all using these oils from the commodities.

And I thought what I would do is, I might just go through a couple of our projects that are of interest, at least to me, and I hope I can share with you my excitement for these products. We got started basically, due to an opportunity of moving the Chemical Weapons School from Alabama to Missouri. And it is Fort Leonard Wood which is only like 25 miles away from Rolla and they were having trouble with the fog oil they are using as an obscurant smoke.

We looked at it and we looked at soybean oil and it appeared to be a perfect replacement for the fog oil, the petroleum-based product. We tried that in the Army equipment; it worked beautifully well. We also analyzed the soybean oil as compared to the fog oil and we discovered that the soybean oil was really the only oil that could meet the specifications.

The Army fog oil did not even meet its own specifications. It had poly-aromatic hydrocarbons which are cancer-causing products. So here we had a product which was perfectly suited for an Army application.

And when the Army was doing the poly-aromatic hydrocarbon control they hydro-treated the product and it made the product expensive, so not only did we have excellent environment effects, we also had the economics based on what they had to do to the fog oil to make it usable.

As well, when we began looking at the oil in more detail we discovered that it absorbed infrared rays as compared to the petroleum oil which does not; which is totally transparent to the infrared. So the Army has to add graphite to the oil to make it infrared opaque, where we can produce a product simply from the oil which is infrared opaque.

So we had all of these advantages for the products and all we are waiting for is for the Army to adopt the program. It will represent about a quarter of a million bushels of soybeans a year just at Fort Leonard Wood to provide the obscurant smoke.

I think this leads to another important point when you think about trying to produce these products and trying to get them adopted. It has got to be bigger than the University of Missouri-Rolla; it has got to be bigger than the Center for Environmental Science and Technology. We have to have the support of the Soybean Association, the Corn Growers Association.

We have to have the support of these people in terms of adopting these products because without their support it will just drop. The Army won't adopt it and nothing will happen. So it is very, very important that we form these kinds of groups.

I will just do one other quick demonstration here; one of our products. This is a composite material that we made. It is carbon fiber of composite. It is exactly like the material that is used in airplanes. We have added soybean oil to the resins in making this product and it has extremely good characteristics.

If you think about it, that sounds good. You are going to make little black rods, but what are you going to use the little black rods for? Here is a product that, this is a rebar replacement made from composites.

Okay, and in order to do this—now the reason they want to do that is because of all the damage we have every year. We have salt on the bridges. So if we could use a composite material we would get rid of all the corrosion problems.

But the composite material is brittle so it doesn't have toughness. So they have to wrap this with a braid by adding the soybean material; the soybean oil, the epoxydized soybean oil to the resins. We have gotten rid of the braid. We don't have to have the braid. Again, economic opportunity to produce a product which has a real need in all of our infrastructure throughout the whole United States.

We are also looking at esters—am I done? That was quick. Well, there are lots of other products that we are working on. They are really exciting. We have got a new way to separate the oil. We have worked with co-ops. We think that engineering expertise is absolutely essential and I think my friend Nick is going to tell you a little bit more about how important it is to have good financial and management services.

So, thank you.

[Dr. Flanigan's statement may be found in the appendix.]

Ms. MILLENDER-MCDONALD. Mr. Chairman, I know that this is out of turn but I have got to leave for another committee. But I just wanted to ask the professor, or Dr. Flanigan——

Dr. FLANIGAN. That is good. Professor is fine.

Ms. MILLENDER-MCDONALD. Scientist. You are saying that corn and soybeans are important commodities for the production of oil or any other, I guess, exploration that we are endeavored in. Are you suggesting that you cannot get them to come to the table?

Dr. FLANIGAN. The Army? That is true. We have had great difficulty getting this adopted. But it is continuing and we are——

Ms. MILLENDER-MCDONALD. So the Army is the one that is precluding this match, is that what you are saying?

Dr. FLANIGAN. Yes, ma'am.

Ms. MILLENDER-MCDONALD. Very well. Thank you. Thank you, Mr. Chairman.

Mr. THUNE. I thank the gentlelady for yielding back and the gentleman for his testimony.

Dr. FLANIGAN. Thank you.

Mr. THUNE. Even a guy with all those impressive degrees still knows the red and the green.

Dr. FLANIGAN. Yes, I am a great sell.

Mr. THUNE. That is right. That is better than I can for many of us on the panel. We sometimes tend to get long-winded. But next we will move to Dr. Nick Kalaitzandonakes. And I don't think that is phonetically—by reading your name here that can't be right but I will take you at your word and I can tell you that is probably not Norwegian since I come from a Scandinavian country.

But please, will you share with us? Nick joins us from the University of Missouri-Columbia, Agriculture Economics Department. Is a renowned expert in the field of agri-business development and the impacts of biotechnology on agriculture. So Nick, welcome, and thank you for coming today to share your vision for value-added agriculture.

STATEMENT OF NICKOLAS KALAITZANDONAKES, UNIVERSITY OF MISSOURI-COLUMBIA, AGRICULTURAL ECONOMICS DEPARTMENT

Dr. KALAITZANDONAKES. Thank you, Mr. Chairman. I have thrown away my prepared comments since many points have been covered. You already have my testimony. I would just like to reinforce some points that were made earlier. As an economist I know that they are valid because we have data to support them.

Now farmers, want to participate in value-added because economics are pushing them that way. A larger portion of the food bill is going towards value-added, post-farmgate. And that means that a smaller portion is being captured by the farmers.

In addition, value-added is tied increasingly to technology and unless you are either the owner or the manager of that technology you are not capturing much of that value-added anymore.

So economics are working their way down to the farm and the trend is very clear. Unless farmers can participate in that value-added activity they are increasingly going to be capturing less and less value from the foods they are producing. Point number one.

Point number two, there are increasing opportunities available for capturing value—there was a lot of discussion about niche marketing and value-added markets and how these relate to each other. What we do know is that opportunities for niche marketing are increasing because we have a better understanding of what markets look like. Right off my computer I can tell you what the market in any particular location looks like in terms of demographics, in terms of income, in terms of product distribution, details that make us better at positioning products to markets.

So we are getting better at recognizing opportunities for product positioning. Electronic data interchange, scan data, internet—all contribute in that direction. So we are getting better at this and we can position products better.

There is also no shortage of products and technology that need to be positioned, as you have already heard from Dr. Flanigan. And you have already heard that farmers can participate in creating that technology and can take it post-farmgate.

Significant disconnect occurs every time in this product-market coordination effort; this is where we need business planning, strategy for value capture and value creation, business plans, organizational design, contract design, and so on.

There was discussion about the issue of "farmer-owned, farmer controlled," brand having value in the marketplace.

In many cases, farmers may process a product only as a stepping stone for creating a brand. And maybe the brand, this "farmer-owned, farmer-controlled," brand may have more value than a processing margin. So we have got to explore these kinds of opportunities and we have to be proactive about it.

And by proactive, what do I mean? There was discussion about cook-book business assistance solutions. In many cases cook-book solutions may work. But what we in my opinion, need is an increasing level of coordination between farmers and technical assistance people that design strategies up-front, even before products and technologies are developed.

So that we go hand-in-hand with markets, products and technology to capture more value.

So I would like to close my statement by saying that where the disconnect right now occurs is in the technology assistance and the market assistance level, and we can do much better for the farmers. When that happens ample opportunities exist and can be captured in the marketplace. Thank you very much.

[Dr. Kalaitzandonakes' statement may be found in the appendix]

Chairman TALENT [presiding]. Thank you, Doctor. Our next witness is Rodney Christianson who is the CEO of the South Dakota Soybean Processors, Inc., and very interested in having you testify. Appreciate your coming, Mr. Christianson because you are the CEO of a successful, producer-owned, value-added cooperative, so I am sure you have a lot of insights to offer the Committee, and thank you for being here.

STATEMENT OF RODNEY CHRISTIANSON, CEO, SOUTH DAKOTA SOYBEAN PROCESSORS

Mr. CHRISTIANSON. Mr. Chairman and fellow members of the Small Business Committee. Thank you for the opportunity——

Chairman TALENT. Excuse me just a minute. If you will suspend for a second.

Let me recognize Mr. Thune for a more extensive introduction.

Mr. THUNE. Thank you, Mr. Chairman, that's not really necessary. I think Rodney is ready to go. But let me just add to what you said by commenting on what I think is a remarkable success story in the area of value-added agriculture and that is the soybean crushing facility at Volga.

It really, truly is I think, what we are looking at in terms of a model. I would certainly hope that it is the first of what will be many successful ventures like that in the future, and Mr. Christianson is here with us today. He is the CEO of that fine organization and I think has a great deal of insights into what makes it work, what some of the problems are, what some of his concerns are with respect to the future and how those might be addressed.

So I am delighted to have a fellow South Dakotan here with us today to be able to talk about what I think are some of the really salient high points in value-added agriculture but also perhaps point to some of the things that we might be able to do to make it more probable in the future.

Chairman TALENT. And I thank the gentleman for his comments. We have models that are successful and they point the way, so tell us how you did it, Mr. Christianson.

Mr. CHRISTIANSON. Thank you, Mr. Chairman and fellow members of the House Committee on Small Business. Thank you for the opportunity to be here with you today to talk about helping American producers re-grow America.

As they mentioned, I am the Chief Executive Officer of South Dakota Soybean Processors. It is a direct 2100 farm family owned co-operative. Our producer members reside primarily in Minnesota and South Dakota. Our goals as a farm-owned co-operative are to add value to our members' soybeans, to maintain a financially strong business unit, and to return a maximum value-added patronage to our members annually.

Certainly the 2100 farm families that invested in South Dakota Soybean Processors believed: (1) that it is possible for the U.S. producer to participate and find success in value-added processing; and (2) for future viability, today's producers need to capture a larger and more equitable share of the food dollars by adding value to their products.

If it is the desire of this Committee and Congress to create an environment—and I will stress, create an environment—for agriculture producers to participate, your assistance should be targeted to the following items: capital formation; producer education and resource centers; and protection against potential anti-competitive and near monopolistic practices of industry giants. Somebody mentioned before that, how do you compete against the giants?

From the early stage of conception the producer needs assistance in the area of education and resource centers. As mentioned previously, a cook-book. Well, the cook-book that you should have is for the process. The solution and how you implement those solutions are not a cook-book and you leave it to the creativity of the producers to make those decisions.

After all, it is those individuals who will be investing their hard-earned money. They have to have that control. But as they go through that process, the challenges they face include overseeing the development of a feasibility study and business plan, creating a capital formation plan, particularly when security laws from state to state vary, developing an organizational structure for the co-operative, and then having the ability to attract the large number of producers to provide both the commodity to be processed and the capital to start and build the operations.

Investments in value-added processing requires outside-the-box thinking by the producers, and likewise for that core leadership group, they need to apply their managerial skills outside of their core competencies of running their farm. They have the skills, but the application is different.

Programs targeted to assist producer education, development of regional resource centers, and seed money for feasibility studies would help create that environment that encourages new value-added processing.

The project's core leadership and potential producers/investors will be told all the reasons why their project will fail out of the gate. Producers and their leaders need to be equipped to make solid, informed decisions to proceed or not to proceed. And they can't be afraid of making the decision not to proceed if it is not economically a viable project.

After the conception is completed and the decision is made to venture into a value-added project, capital is absolutely needed as the fertilizer to make the seed grow. A cooperative being undercapitalized is one of the top reasons for failure. Value-added processing is capital-intensive, cyclical in nature in both commodity prices and margin structure, and is in a highly competitive, ever consolidating corporate world.

If Congress had to choose only one method to assist agriculture producers entering value-added processing, I would strongly urge capital formation as the area that you should put your resources.

The use of low-interest loans, loan guarantees for individual producers to purchase co-operative stocks, and low interest or loan guarantees directly to the co-operative would also encourage producer participation.

Over the last year it is my understanding that $200 million was available out of the Co-operative Stock Loan program through Rural Development. This program could have provided producers and lenders to producers up to 80 percent loan guarantees on the purchase of value-added co-operatives. While well-intending as that program was, one needs to question why this program was not utilized at any measurable degree. It is my understanding that the complexity of this program prevented lenders from participating. Certainly, simplifying red tape requirements for funding availability is essential if Congress truly desires to implement a successful assistance program.

SDSP would also specifically request that in such programs, the requirements of "new" co-operative qualifications be dropped from the program. Unlike the co-operative systems that have been in existence for several years returning 20 to 30 percent of the profits to members through patronage dividends each year, the value-added co-operative is driven to have a maximum value-added payment every year.

SDSP has returned 70 percent of our profits each of the two years that we have declared a patronage dividend to our members. Therefore, should SDSP desire to expand into major projects, we will require receipt of capital from our existing members or new members. It only makes sense to support value-added ventures as a whole, whether a new, high-risk co-operative or a proven, stable successful one.

The last area that I request your consideration is how and will Congress be willing to provide a level playing field so that a producer entering into a value-added project will have an opportunity to return an equitable return for their investment?

I am confident that the U.S. producer who invests in value-added processing is willing to compete fairly in those chosen industries. The question I would raise, will Congress be willing to provide a level playing field for that producer-owned venture against industry giants and the food transportation industry?

Many producers have severe reservations about investing in value-added agriculture due to anti-competitive action by industry giants. SDSP has had a couple of situations that we have struggled with, both with the rail transportation system where there is a lack of competitive corridors in all areas, and also with the Chicago Board of Trade and some changes that they've made.

And if you have questions we can go into that. You have that in your written testimony for the details on it. But I think that it is important that you take a look at it, and again, I am going to stress that the U.S. producer that invests in value-added agriculture is willing to compete fairly with those chosen industries.

But let us be honest and realistic at the same time. The business and the profits captured by agricultural producers will be considered business and profits lost by a major competitor.

A successful campaign that will encourage farmer investment will include assistance with capital formation, producer education and resource centers, and protection against special, anti-competitive or near-monopolistic practices of industry giants.

On behalf of our 2100 farm families I would like to thank you again for this opportunity.

[Mr. Christianson's statement may be found in the appendix.]

Chairman TALENT. Thank you, Mr. Christianson. I hope that you could give some further thought to helping the Committee to determine what those assistance centers or ag innovation centers or whatever you want to call them, what they ought to look like, to help us learn from your experience and then provide some shortcuts to some people maybe in other states.

We have learned over the years, everybody starting in a new kind of business needs some assistance in technical assistance. And some of our programs have been very good. Some of them have missed the mark. And it just depends a lot on how you set them up. And since you have a real life experience I hope you would be available to help us.

Mr. CHRISTIANSON. I will try to help you on that.

Chairman TALENT. Okay. The next witness is Mr. Dayton Watkins. He is the current Administrator of the Rural Business Co-operative Service of the USDA. This division is part of the USDA's world development mission area.

Mr. Watkins, thank you for appearing today to tell us what the USDA has been doing to encourage producer-owned, value-added endeavors and to share any other observations you may think appropriate.

STATEMENT OF DAYTON WATKINS, ADMINISTRATOR, RURAL BUSINESS-COOPERATIVE SERVICES, UNITED STATES DEPARTMENT OF AGRICULTURE

Mr. WATKINS. Mr. Chairman, thank you very much. Thanks to the Committee. Thank you for your vision for wanting to hold this hearing this morning.

As you know, the Department of Agriculture falls under the House Committee on Agriculture, and it is very rare, certainly during the time that I have been with the Department of Agriculture, that we have had an opportunity to come before the House Small Business Committee. I applaud you and I am thrilled to have this opportunity.

The Rural Development Mission Area views producer-owned, value-added enterprises as a means of assisting the individual producer increase profitability of their operations. We view them as critical to the stability of economies in many rural communities.

Value-added enterprises create new employment opportunities in which most of the income generated from these investments tend to stay in rural areas and supports other businesses.

I should point out that it is not only Rural Development that is involved in providing assistance to producers as they enter into the value-added arena. A number of agencies have contributed significant time and resources to specific projects, and success of these enterprises is dependent on this cooperation.

The Alternative Agricultural Research and Commercialization Corporation, the Natural Resources Conservation Service, the Farm Service, Agricultural Marketing and Research and Extension components of USDA have been involved very actively and aggressively in these endeavors.

A most recent example that involves a variety of sources of technical assistance and very little financial assistance in Northern Florida, a co-operative was created by limited resource farmers and they are providing fresh vegetables and fruits to the local school districts.

This co-operative evolved through efforts of many parts of the USDA, including Natural Resource Conservation, Agricultural Marketing, and the Florida A&M University. The Rural Business-Cooperative Service provided some assistance in helping the co-operative organize and a local bank provided the financing for a processing and packaging facility.

The Rural Business has a variety of programs that we are using to finance value-added facilities. But the flagship program that we have in the agency is our Business and Industry Loan Guarantee program. This program is used to provide loan guarantees or direct loans to value-added processing entities, growers and producers who are forming such entities, and for those growers to obtain financing to purchase stock in those co-operatives.

For the past few years, the Business and Industry Loan Guarantee program had a program budget of one billion dollars. To stimulate agriculturally-related value-added projects we have a policy of setting aside $200 million of our B&I Program authority for value-added, grower, producer co-operatives.

In 1998 we funded $36 million in value-added co-operative transactions, and in 1999, year-to-date, we have financed $44 million. As an example, we provided $20 million guarantee to a sugar beet processing plant in eastern Washington.

We have also provided a government guarantee to a swine processing plant in Minnesota. We are also using this program to participate in projects financed in part by the Agricultural Research and Commercialization Corporation. One such project is a soybean processing plant in Michigan.

Other financing programs available from Rural Development Mission Area include the Rural Business Enterprise Grant program through which we are able to assist small and emerging businesses with facilities, feasibility studies and marketing studies, and the Rural Economic Development Loan and Grant program.

The Rural Business-Cooperative Services also provides technical assistance, research assistance and the like, to existing and new cooperatives. The Cooperative Development Grant program provides technical assistance to cooperatives through a network of co-operative development centers that are located throughout the country.

These centers have been instrumental in the establishment of new ventures. Examples would be a pasta plant in North Dakota, a bakery in Colorado and many others.

In addition to Co-op Services here in Washington, D.C., we have a series of co-operative development specialists that are employed at the state levels and those who do not have full-time co-operative specialists have co-operative specialists who have collateral duties. In other words they get involved in other business services that we provide through Rural Business.

Mr. Chairman, let me conclude my comments with the next to the last paragraph in my testimony which says that, unfortunately the producer interest in co-operatives, in value-added enterprises increases when commodity prices are low and wanes when prices begin to rise.

It is fairly difficult and it has been difficult for USDA and our Co-operative Services Division to convince small producers and ag producers throughout the country that it is to their economic benefit to participate in value-added co-operatives, though we are continuing in that fight and we think it is the direction we should, as the Agricultural Department of the United States, should be going.

Thank you very much and I will be here to answer any questions that may arise.

[Mr. Watkins' may be found in the appendix.]

Mr. PHELPS [presiding]. Thank you, Mr. Watkins. I have been given the scary assignment of holding the Committee in this hearing on the minority side. That may be a little bit unusual, too, but maybe we can do this with your help.

I have several questions probably for all of you. I think we will be joined here very shortly with other members.

Dr. Flanigan, you had mentioned—first of all, the dear gentlelady had mentioned from California, her interest in ports, and you alluded to the fact that, in answer to her question, that the Army has had some slow response or resistance. Why do you think that is? Are there competing interests or just a lack of focus on programs that we need to make sure happens from the Congressional view?

Dr. FLANIGAN. I think that the first thing as you well know, the environmental permits for this kind of an operation are very difficult to obtain. So when you switch from one product to another product that is going to require some effort. And I think there is some lack of enthusiasm in terms of going through that exercise again.

Even though I think the soy oil really shows so many positive characteristics as compared to the petroleum-based product. But I think that is one of the main ones. They are really reluctant to——

Mr. PHELPS. Transitional costs, then?

Dr. FLANIGAN. Yes, even though I think, you know, we have talked to EPA and we have talked to the DNR in the state and they are both very encouraging in terms of making the switch to the soy product.

Mr. PHELPS. Is there any co-operative effort in trying to, I guess convince them that it doesn't have to be so abruptly? Is there not a gradual plan to get there that could pay for itself as they go along, so to speak? I think that would make sense.

Dr. FLANIGAN. It does to me. We have suggested that. We have not gotten very far with that. It doesn't have to happen instantaneously, needless to say. It could be spread over five years, probably. But they haven't been willing to do that.

Mr. PHELPS. So there is just a resistance there in strategic planning, sounds like.

Dr. FLANIGAN. Yes. And that is why it is so important, I think, to have the support of these farmer groups because they really can apply pressure that I as a researcher—you know, it is very hard for me to apply very much pressure, needless to say. I think with continuing pressure we will get there. It is just a matter of how long it takes.

Mr. PHELPS. Can you elaborate or clarify for me—I have some general understanding of esters. It is a biodiesel component, I guess. That is a lucrative market also, isn't it, that we can capture? Can you elaborate?

Dr. FLANIGAN. In fact, if we go back to this product here, the smoke, we have looked at the methyl esters as well as the soy oil and we can even make a better smoke with methyl ester. And it has some improved properties. Methyl ester is going to be a real product of choice in the future.

When you look at polymers I think you almost always end up going to methyl esters. And now we have developed some other esters—and I don't want to get into a long chemistry talk because everybody will go to sleep on me—but we have developed some new esters that even tie up the soy oil and the other vegetable oils much better in terms of making polyers.

So there are all kinds of positive things in the relationship to esters. And we have got the ester for paint and we have got a patent and it is being sold presently. And the technology is being sold and it gives us all kinds of opportunities to try to get money back to the farmer.

But it is not the methyl ester that you are used to in the soy diesel. It is another one using another product. So there are all kinds of opportunity there and I think we are going to see more and more esters being produced all the time.

Mr. PHELPS. So essentially your R&D funding has come through Congress or is it the private sector?

Dr. FLANIGAN. No, most all of it has been from check-off funds.

Mr. PHELPS. Okay.

Dr. FLANIGAN. Now we are working over in the hog area as well and that is all through some local state—we are looking at manure incineration in some of those, and odor detection, odor measurement. That is coming from other sources.

Mr. PHELPS. I see. I see.

Dr. FLANIGAN. Other state sources, not federal sources, though.

Mr. PHELPS. The soy oil that you refer to, there are several advantages in your written testimony over petroleum-based oil. Is lower cost you say, and——

Dr. FLANIGAN. Well, it is in this case because they have to go through severe hydrotreating. But I think if you go in the markets you are going to see—Rodney can tell me better what today's price is probably than I can. But it is going to be two dollars a gallon or close to it. And so it is 25 cents a pound. Where gasoline, needless to say, is not that high, even with the rising prices.

So that is why you have always got to be very careful when you are talking about these fuels when you want to look at them as fuels. Because it is difficult to maintain economic advantage, which I think you have got to have for the most part.

Now, Nick will argue with me there. He says with brands we might be able to change that. Which is true.

Mr. PHELPS. Would you like to elaborate on that? Do you believe it is?

Dr. KALAITZANDONAKES. Sure. We have many, many examples right now where the bran is worth a whole lot more than the product itself in terms of how much money it brings relative to processing margins and so on. There are co-ops that have been very, very successful in marketing their products as "farmer-owned, farmer-controlled" or "farmer-produced," and create a whole lot of value out of that image.

So in many cases, processing may be a good way of adding value and capturing some of the value. In many cases it is simply a stepping stone towards capturing value from other assets; in this case, a brand.

Mr. PHELPS. In your opinion—I am going to call you Dr. Nickolas if that is okay.

Dr. KALAITZANDONAKES. Sure. Absolutely.

Mr. PHELPS. In your opinion, I am interested in looking at your managing innovation of value-added products. There needs to be a—what is the single, most important coordinating factor? I mean, if we have these centers set up similar to what we have in small business and it is why I felt like the Chairman's vision of bringing agriculture and small business together was very resourceful.

How can it be made to convince farmers that they are in good hands if you have a management problem, I guess barrier. You need a success story as you have had, like we said in the soybeans which Mr. Christianson has so ably indicated, how do we get there past this organizational problem? Do we need strong leadership somewhere? The private sector and government hand-in-hand?

Dr. KALAITZANDONAKES. Absolutely. And we need to put those things together in such a way that they make sense. Managing new technology fails typically in one, unique way; it doesn't matter what industry you are looking at. And that is bringing technology to the right market and the right market to the technology.

In other words, putting those two together. A lot of very, very good technologies fail when they get to the market because they do not have a really good business plan or a good strategy for positioning.

In other cases creating value does not mean that you can actually capture any. So how you put this together right is by making these functions go hand-in-hand.

In other words, the technology side and the business side have to go together, and hopefully in a pro-active mode. The strategy and the business plan go before the technology is actually developed rather than after. But in some cases we do have really good technologies that we can market ex-post.

Mr. PHELPS. Mr. Watkins, thank you for your testimony, your input from the Department's standpoint. It seemed like one of the main difficulties that farmers have faced, at least in the past when trying to form co-operatives, and you have alluded to—all of you have sort of referred to capital being so important in the process; accessibility to capital.

Especially when we are talking about farmers who are already in dire times. What is your Department doing to facilitate the—to encourage individual farmers to participate in co-ops? Are there incentives or things in place to help decide that?

Mr. WATKINS. Well, thank you very much, Mr. Chairman, for the question. Prior to 1996 farmers who wanted to join a co-operative, a marketing and distribution co-operative, either had to use their own financial resources to buy their shares in a co-operative, or they had to go to a lender, borrow the money, and then they would have to, in the normal underwriting of the loan, they would have to pledge their assets.

They would either have to pledge their land, their house, put up a personal guarantee, their next several year's crop production, or whatever. It made it very difficult for farmers to pledge their assets because now they're moving into other than agricultural production but a new business venture. A lot of those business ventures did in fact, fail and farmers did in fact, lose their property.

In 1996 the Agricultural Committee, through its wisdom, added in the 1996 Farm Bill, an opportunity for my agency to use the Business and Industry Loan Guarantee program to guarantee a farmer's purchase of stock in a co-operative. The incentive is that a farmer now can go to a lender, borrow the money, and not have to pledge his assets but pledge the stock that he purchased in the membership co-operative.

Now that, in and of itself, is an opportunity and it should in fact, create a groundswell of small producer's participation in value-added processing and production.

However, to get to that point they need to be educated. They need to understand the opportunities of value-added processing; they need to understand the economic opportunities. They also need to be fully aware of the risk involved in participating in value-added processing. And we are in the process right now throughout the Department of Agriculture, of providing that information.

We have the Co-operative Services Division within my agency. They provide technical assistance, education and feasibility studies to grower/producer groups who are interested in considering value added cooperatives. Even before they decide to form a co-operative, if they contact us we have people who are around the country who go out and provide technical assistance and education.

In addition, the 1862 Land Grant Colleges and Universities, which are predominantly agricultural universities around the country, many of them have Small Business Development Centers located on those facilities.

Farmers need to begin to access them as other small businesses that are involved in whatever their industries are around the country, to gain access to technical expertise and assistance.

There are many other things, Mr. Chairman, that we are doing in the Department. We are currently—we have developed the specific part of the regulation that will address the stock purchase part of our B&I program. We have streamlined it, we have made it user-friendly, we have made it efficient and less bureaucratic for farmer groups who are becoming involved in value-added co-operatives to gain access through their local lenders.

Mr. PHELPS. So your long-range goals are somewhat in place?

Mr. WATKINS. Our long-range goals are in place. It is a highly visible objective and goal and priority for the Department of Agriculture to move more small producers into value-adding processing activity and to get them into niche markets.

And let me add, very recently I began discussing the development of a partnership with the Foreign Agricultural Service Agency in USDA. What they want to do—heretofore, they have focused most of their time and efforts with big co-operatives in terms of moving them into international markets.

They now understand that the philosophy in USDA is to develop additional economic opportunities for small producers who are in value-added. Well, one of the problems with putting small producers in value-added is that once you get into value-added you need a market for the distribution and sale of your product.

Foreign Agricultural Service is partnering with us to help those small producers who develop value-added co-operatives find opportunities to export their product in foreign markets.

So yes, we are well on our way to a long-term strategy within the Department of Agriculture, focusing on value-added and small producers and having them fully participating in that stream of economic opportunity.

Mr. PHELPS. And what local agencies through your Department actually will communicate that?

Mr. WATKINS. Well, all the agencies within Rural Development, which would include my agency, Rural Business and Co-operative Services. But it will include the Foreign Agricultural Services, the Agricultural Marketing Service, Natural Resource Conservation Service. So most of those agencies within Agriculture that have a role or an involvement in either identifying market opportunities in the international and within the domestic market, and those that provide assistance directly to the farming community—which is the farm services agency—and then my agency which provides the assistances to other than agricultural production businesses.

Mr. PHELPS. As I turn the chair back over to Congressman Thune I realize that allowing farmers, it has been said could be an advantage, to deduct from their taxes the dividends from their membership in co-ops.

Is that a big problem? Is that something we can help develop through your agency? I know it may take action through Congress, but is that an encourageable item you think?

Mr. WATKINS. Frankly sir, I have not seen that as being an issue for creating and for farmers going into value-added co-operatives. It may be. It has not been an issue that has surfaced to me.

Mr. PHELPS. And it might be that Mr. Christianson is going to elaborate on it because I know in your statement too, it caught my eye that creating the capital formation plan, the securities laws vary from state to state——

Mr. CHRISTIANSON. Well, with regard to taxes, any economic incentive that raises their return on their initial investment is beneficial. As the patronage comes to the producer today, it is considered normal income, so not only income taxes but also social security taxes apply to it unlike investments in other corporations. The dividends that come to them should be taxed differently, I believe. Any time you add value and increase the potential rate of return on the investment, I think you are going to get more people involved.

Now with regard to securities, as you go across states, and again, most value-added businesses are going to require large commodity volumes. In the development phase, in order to raise capital from farmers in other states like Minnesota, North Dakota, Iowa, the hurdles to involve farmers from multiple states are different and you end up doing the same thing four or five times, which is costly.

Our group itself decided not even to try in Nebraska because of some of the securities issues in that state. So even though that may have been an area that we may have gotten some interest—and again, Minnesota Corn Processors had success expanding down there—SDSP chose not to take that hurdle.

Mr. PHELPS. I see. Thank you very much.

Mr. WATKINS. Thank you.

Mr. THUNE [presiding]. If I might just—and forgive me if I am asking questions that have already been asked—but elaborate on some of the testimony and some I think line of questioning maybe you have already gone down.

One of the things I was reading in a South Dakota publication the other day from the Department of Agriculture was that the number of producers who use computers in their operations is like 31 percent. Which would seem to me in this day and age, somehow we have got to be pushing that up higher.

You know, if this in fact is a business operation that relies upon information for decision-making, that somehow—and to me it comes back to one of the things that we talked about and that is sort of the education curve and how do you get this information and this body of knowledge that you all are talking about, out in the hands of actually the producers and whether or not there is a federal role in that.

We all struggle with the current budgetary constraints that we are under here at the federal level as to what should be the federal role in terms of education, you know, and technical assistance. And I am just curious to successful models with channeling information for producers that want to add value to their products.

I mean, what is working out there? And if there isn't something what is the federal role? And I understand that Mr. Watkins is involved in that on a day-to-day level, but are there other ways, better ways that we can improve the technical assistance that we provide?

Mr. Christianson.

Mr. CHRISTIANSON. Well, let me respond as I look at successful models, and I am going to take note of two particular local organizations in the Dakotas. First the Quintin Burdick Center on the North Dakota State University campus has been focusing on providing education at the Board level for new generation cooperatives. The governance and responsibilities that a former Board member has in running a value-added co-operative, particularly with regard to the size, structure, and organization of professional personnel they hire to manage their cooperative, is much different than that of the local co-operative they all have been very familiar with in the past. The Quintin Burdick Center is trying to address that issue and they are through the development stage and I think can be used as one example.

Then in South Dakota, through farmer groups like the Soybean Council, the Corn Growers, Pork Producers, as well as cooperatives such as South Dakota Soybean Processors and South Dakota Wheat Growers Association, have funded a non-profit organization led by an executive director. We are trying to focus on learning where the resources are so that a new farmer group coming along may be able to do one-stop resource shopping, if you want to say.

The intent is to not replace the work of the Soybean Council or the check-off dollars through the Pork Producers—but to help coordinate that. The other goal is to work together where help and support is needed, either from the state level or from the federal level. We don't want different groups of farmers thinking that the pie is a fixed piece and then fighting over it, but asking how do we move the whole process forward?

Certainly the other models I think are a success, are those organizations that use check-off dollars like the United Soybean Board. That is a farmer-directed group doing a lot toward trying to understand and develop additional markets. Why would not that type of model also work toward farmers becoming owners of businesses? And certainly the Small Business Administration has been successful in the business environment all the way along.

So I think there are several models out there that you can take a look at. And then the question is, how can the federal government help with some of the funding sources to establish and maintain resource centers?

Mr. THUNE. Anyone else want to comment on that?

Dr. KALAITZANDONAKES. Well, I can give you another example from Illinois where processing is not involved; where farmers got together and formed an LLC and basically got into identity preserved markets. They have very innovative contracts to deliver to specific end-users, specific soybeans from specific varieties with specific properties. That adds value to them and to the end-user; they share that.

So back to the point. I don't think that there is any singular model to be had, and that is part of what we are discussing here in terms of the technical and business assistance; in that forming the right strategy in particular markets, even particular local conditions, is part of how farmers can be helped.

I don't believe that there is a cookie-cutter, singular model that we can put in place and make it work.

Mr. THUNE. Okay.

Mr. WATKINS. Mr. Chairman, through our Co-operative Development Grant program, which is funded at the tune of about $1,750,000 a year, we are able to fund non-profit organizations within states that focus on co-operative development.

And in 1999 we funded about ten. The average grant to them was about $180,000 apiece. And they have been quite successful. They have worked with local universities within their jurisdiction. They have probably worked with Small Business Development Centers as well, and other resources within the state to encourage grower groups participating in value-added processing.

That might be a model for the Small Business Committee to consider in the future.

Mr. THUNE. Well, it just seems to me that there are in the existing infrastructure, ways out there of doing this. To me, value-added is really emerging as, not the salvation but certainly an important part of the future of agriculture in this country.

And if we can redefine the mission or the role or whatever of some of these existing mechanisms that we have in place to provide that sort of assistance so they are more focused on, you know, cooperatives, value-added enterprises, things like that, it would seem in my judgment to make a lot of sense.

But just one other question if I might. I see the Chairman is back. I will be happy to yield back to him in just a moment.

One of the things that I have heard—I did it during the month of August; a 36-county tour across South Dakota. Granted, that is only about half of the counties we have in South Dakota, but I was primarily in rural communities, smaller towns, towns that there is a tremendous amount of frustration because of the economic difficulties that they are having out there.

And much of it is tied to agriculture. There are fewer and fewer producers farming more and more land, and so you don't have the population base to support a lot of those small towns. So there is a real sense of frustration and sort of, and in some ways almost resignation, about where do we go from here.

But one of the things that everybody was focusing on in terms of identifying, trying to define the problem of this whole issue: concentration. And I know Rodney, in your testimony you referenced this situation with the railroad and how at least at the transportation level, the lack of competitive alternatives is dramatically impacting your ability to market your product at a reasonable price and the cost of freight factored into that.

My question I guess for you and for anybody else who would care to take a stab at it is, to what degree is this going to be a factor?

How is it going to impact and what can we do to address that? There have been some suggestions that we come up with legislation that would prevent for example, vertical integration; that would prevent packers from owning their own livestock unless they are ready for active slaughter, and some things that are legislative in nature in terms of solutions.

And I don't know that that is the track we want to be going down. But it is a concern for producers and I am just curious what your observations might be with respect to that issue.

Mr. CHRISTIANSON. Well, certainly what I would stress for a producer to make that investment, the concern of consolidation and the market power of industry giants is a hurdle that they need to get over.

I am not asking for any particular movement that prevents the flow of world economics. The pressures we are experiencing and it is not only happening in the United States, it is a world economic issue driven by consumers and by the shareholders of large corporations.

We want to have a level playing field. You have heard from agricultural industries that want to have a level playing field in the world market because different countries, depending on the socioeconomics of that country, have advantages and disadvantages.

I believe that small producer-owned co-operatives against the industry giants could be viewed and looked at in that same way. There are areas of oversight that this government has that are available to use oversight in regulating actions we consider anticompetitive in nature.

And let me refer to the Burlington Northern example. Now, their motivation and their view of marketing is that they are providing their customer marketing opportunities by allowing them to purchase meal from a variety of shippers located on the BNSF line. So the BNSF believes that they are doing the market justice.

Our view from where we sit is that we have located our facility and have made other capital investments to more fully utilize rail systems, to put us as the high-quality, low-cost producer to particular market segments.

Now, what the BNSF has done is increase our transportation rate to that particular location that puts our other competitors on a level playing field with us. But if a company has invested capital to expand their capacity so they have a lower unit cost, the end user might as well go for that option.

One example in the written testimony is, we have shipped a fair amount of our meal up to Sweet Grass, Montana to be exported to the Canadian consumer. We pay $500 more for every car that goes that direction even though we travel 212 miles less.

So from our perspective, the BNSF has taken an opportunity to capitalize on our producers' investments by keeping a little bit more of the profits in BNSF's pocket. And either the consumer or SDSP is going to have to pay that.

Our approach is to try to introduce other transportation competition by first loading 1500 trucks with meal, shipping them 125 miles on South Dakota roads, and then reload them into the Canadian Pacific line. So we are not going to lay there and take that business because it is 30,000/35,000 tons we have been putting through there in the last two years.

That is our recourse today. We would like to have a recourse that could challenge BNSF's rate structure effectively. When our cost per mile, due to the lack of competition, is 54 percent higher than other suppliers on the BNSF, we don't see that as just. But we are willing to compete and deal in that market.

Chairman TALENT. Would the Chair yield just for a minute?

Mr. THUNE. If not the Chair, I will at least yield the microphone with the Chair.

Chairman TALENT. No actually, I want you to continue because I want to develop this record as much as possible. This is an initial hearing and I am very hopeful the Committee will follow-up in this direction because again as I have said several times, what I have heard from the ag community—and in a united way.

I mean, there are certain things the ag community is debating right now. But the importance of value-added, it isn't. And Mr. Watkins, if you have any contrary information on that please tell me. But this is something I get a sense from every part of the ag community that value-added is important.

And we are very glad to have you here today. We have not before. Just so often when we encounter Small Business issues they were rural issues, they were ag issues. And so we did start a Rural Enterprises Subcommittee and we certainly want to work with you and the ag committee on all these issues and we are grateful for the work the Department has done.

But I want us to follow up with this. And so I am going to have to go. I am sorry I have had to duck in and out but I would hope that you and Mr. Phelps if you want to, and others from the Committee with real experience on ag issues, would help us develop legislation or whatever we can do to help in developing these value-added enterprises.

So I am going to let you stay in the Chair and please, as long as the witnesses don't mind, continue developing this record.

Mr. THUNE. Thank you.

Chairman TALENT. I will yield to Mr. Phelps if he has something.

Mr. PHELPS. I too, am going to have to go but I just wanted to commend you again for your being able to identify the value of these communities coming together, because agriculture is the backbone of not only this Nation, but of course the hub of rural America.

So to the Congresswoman, the ranking member who has given me the opportunity I want to thank her because her interest, even though she does not have a lot of agriculture——

Chairman TALENT. We are told that she has a farm in her district. And Ms. Velazquez is going to try and find it. But she does have a farm and it really is—I want to also state for the record my respect and appreciation to her for her cooperation. Because this is not something that is immediately big in her district. But she recognizes the importance of it as well.

Mr. PHELPS. For those members of the first panel I didn't get a chance to say that I had the tee shirt, so forth. The only other thing I could say that might increase the market would be these biodegradable golf tees that I have seen. Very little I have used;

I don't play much. But believe me, that could be an increasing market, especially the number I use trying to get off the tee.

Thank you for the opportunity.

Chairman TALENT. I yield back and I thank you, Mr. Thune. I just would encourage you again, to put on the record anything that you need. Mr. Christianson's statements about how we need to put some things in the law to give them some assurance they won't get snuffed out by some larger enterprises is I think important, taking some of the risk out of this investment.

And we have to decide how much we can do and how much we start getting into jurisdictional problems here, and I don't want to get any inside baseball-type things. But that is very interesting and I had not heard that related before your testimony.

Mr. THUNE. I thank the Chairman for yielding back. I don't have any further questions. If anybody else would care to comment on that last question on the concentration issue just for the record. If not, we will conclude and let you all get to lunch.

Mr. WATKINS. Mr. Chairman, let me suggest that the concentration issue is very important to us at the Department of Agriculture, and the Secretary's Office has been involved in having studies done and has created a task force within the Department to focus on that issue.

Further, there is a task force that is comprised of the Economic Council of the President that is also looking at the concentration issues. So we are very much involved in it.

Let me also add that, you know, we have had considerable experience in the Department of Agriculture in forming co-operatives and in forming value-added co-operatives, as a matter of fact. The Co-operative Services program was created and has been in place for 73 years. So we have a cadre of experts who are knowledgeable in the area and they provide services and assistance throughout the country in rural America.

And we serve on panels and participate with professors at the various local universities who are experts in their field as well. And we have had successes and we have had failures. I would just like to go on record with a couple.

I mentioned in my testimony a sugar beet processing facility that was created in Washington State. The Co-Op bank last year provided $120 million to this value-added group of beet growers who wanted to create this facility. And they invested the money, they built the facility, installed all of the equipment. And on the day that they turned on the electric switch the equipment didn't work.

They came to us this year and asked, would we guarantee a $20 million additional loan to the company, to the growers, for them to now correct the problems and begin to operate their plant.

We did our review and analysis of transaction, they came in with a business plan, feasibility studies. They convinced us that they had the management and technical expertise now to go forward and to operate this business and to be successful. And so we did. We guaranteed the $20 million deal. So we are waiting to see what happens.

In Maine, several years ago we financed a group of potato growers who decided that they wanted to do value-added to their potatoes so that their potatoes could compete with Idaho potatoes head-to-head in the marketplace. They met all of our requirements for a B&I loan guarantee. They borrowed about $8 million; they built a new facility; they installed their equipment.

As a start-up business they had startup problems. One of the major problems that they had was that they had miscalculated their market and they had miscalculated their ability to enter that market. And so they ran through their entire equity investment that they made in their company and came back to us for additional financing.

Based on our review of the financials and our analysis of their financials going forward, the company could not assume any more debt. The only thing they could do was to find additional equity to put in your company.

In the meantime, if they found that equity, we will put a moratorium on the payment of principal and interest on the debt until the company could be restructured and reposition to be successful. Lastly, they also have to find the management and technical expertise needed; not those of growers but those of business people who have been in this industry, who know this industry, who are experts in this industry.

They have been able, in fact, to do that and just recently I got an e-mail from one of my staff who said that he was shopping at a Giant store in a local community here in Washington and he saw this company's potatoes in there; which is new because we haven't seen any in the local market since we financed this company.

We also have a group of 500 growers in North Dakota. They decided that they wanted to do value-added oils: cremly oil, sunflower seed oil, other oils. They had their marketing and feasibility study, they had their business plan, they had their management and executive team in place. And we thought that their deal was an outstanding deal and we agreed to provide the guarantees.

That was in 1995. They called me several months ago and asked me would I, because of problems that they had in this startup business, would I waive their, or forgive, $2.5 million of a $5 million loan?

Unfortunately, in the Business and Industry Loan Guarantee program and in my agency which I tend to believe to be the business agency of USDA, we don't forgive loans that we make to business people. If there is a problem and we have to foreclose, then we foreclose and we sell the assets but we try to do the best that we can to replenish the funds so that other business people who are interested in their business activity in rural America can gain access to these resources.

Long story short, yes, we would like very much to keep these 500 growers who decided to go in value-added processing, in business. And we came up with several scenarios for them to stay in business, one of which was, we will not forgive the $2.5 million loan. We will put a moratorium on the payment of principal and interest.

We will, as a matter of fact, not charge you interest for the next 20 years. We will allow you to pay us a minimum payment every year based on the amount of profit that you make out of your business, but we want you to stay in business.

As I understand, they didn't like that idea and decided not to accept it. Our only alternative is to foreclose on that plant, tear down the assets, sell them to whoever is interested in buying them, and close that business activity.

Doing value-added business is just as risky as any business that the Small Business Committee has extensive knowledge on and extensive experience with.

The same businesses that are technology-based that are located in urban and suburban communities, where you must know your market, you must know that you have the technical and expertise to enter that market, and that you are capitalized to the point that you can withstand the barriers that will be thrown in your direction to keep you out of it.

We are not talking about new markets that these value-added companies that are owned by growers are going to be participating in. These markets and these products, for all practical purposes, are already being produced. Someone in the middle is producing the product. That person in the middle, that entrepreneur, that business that is located in rural America, is the competitor.

So entering into value-added businesses is not as simple as it may seem. It is very risky, it is very difficult. But there, if you do it right, the opportunities for entering that business for growers is phenomenal. Thank you.

Mr. THUNE. Well, and I guess producers look at this in some regards as sort of the last hope, and that is why we want to make sure that everything is in place to do it right and there are some very notable success stories. But understanding again that there is a tremendous amount of risk in small business venture.

So I want to express my appreciation to the panel. I thank you for your observations, insights. I look forward to exploring this topic further in the future. I do think that there is a real crossover between small business and ag.

I also serve on the Ag Committee but I can certainly speak from firsthand experience that most of the small business in our part of the world in a lot of ways, is tied directly to agriculture.

And so there is a lot of overlap there and these are issues that are important I think to the future of this country since small businesses create a lot of the jobs. And I hope will continue to do that and hopefully keep a lot more people on the farm, too.

So thank you again. We will, by unanimous consent, keep the record open for an additional ten days. If there are additional questions, comments on behalf of members of the panel so that we can get those answered. And I want to thank you again for coming, and with that, the hearing is adjourned.

[Whereupon, at 1:14 p.m. the Committee was adjourned.]

Congressman Jim Talent
Chairman, House Committee on Small Business
Introductory Statement
Committee Hearing:

Helping Agricultural Producers "Re-Grow" Rural America

Washington, DC 20515
September 29, 1999

I would like to welcome the participants here today for the House Committee on Small Business hearing titled: **Helping Agricultural Producers "Re-Grow" Rural America**. Your willingness to take the time to testify at this hearing about the opportunities and needs of agricultural producers as they pursue the development of value-added enterprises, will provide us with invaluable insight into what Congress needs to do to assist these entrepreneurs.

Thomas Jefferson, the third President of the United States is remembered for many things. In fact, his epitaph reads, "Thomas Jefferson: author of the Declaration of American Independence, of the Statute of Virginia for Religious Freedom, and father of the University of Virginia. However, what his epitaph doesn't tell us, is of the love of land and business – farming and commerce -- that Jefferson so deeply believed was a part of America's fiber. But on several occasions Jefferson referred to the virtues of agriculture and the importance of it to our nation's prosperity. In his first inaugural, in 1801, Jefferson wrote: "Encouragement of agriculture and of commerce as its handmaid I deem [one of the] essential principles of our government, and consequently [one of] those which ought to shape its administration."

Although, Jefferson's America was one in which the majority of the people were engaged in the production of food and fiber, I still believe that his spirit of admiration for agriculture and his dedication for the "encouragement of agriculture", remains true today. He could never have imagined what our American agricultural system would become. On average, each and every American farmer and rancher feeds and clothes himself and 126 other people. Our agricultural producers truly deserve to be honored for their hard work in providing our nation with the most affordable, most abundant and safest food supply in the world. This "plenty" that American producers provide to our citizenry, has allowed our Nation to prosper beyond any of the expectations of Jefferson.

Record high disasters and record low commodity prices are hurting America's farmers and ranchers. I believe, as Jefferson, that it is one of the essential principles of our government to ensure that our agricultural system remains viable. Plainly, we must help producers through these tough times. While it is obvious that producers need near term assistance, it is important that we do not become short sighted, and loose vision of the opportunities for the future. As a local farmer back home reminded me recently, farmers don't normally want a hand-out – instead, what they need is a hand-up – to the future of agriculture. The opportunities of the future depend on the expansion of export markets for our farm products, and the development of new and innovative, producer owned marketing systems.

Of course, much of the opportunity of the future lies with feeding and clothing the world's growing population. Unfortunately, the current world demand has been down for our agricultural products. This is directly affecting the livelihood of U.S. producers. For example, historically the southeastern region of Missouri, due to the availability of river transportation to the world market, has enjoyed, at worst, a neutral basis (difference between cash price and futures price), and often a positive basis on corn during August. This August, corn producers in southeast Missouri were faced with cash, farmgate prices as much as a $0.50 below futures prices. This down turn in world demand is caused by two primary factors, the Asian economic crisis and the unfair trade barriers on U.S. agricultural products by the EU based on the unfounded fear of biotechnologically enhanced crops. On top of this, our current administration continues to hold our producers hostage by using food as a weapon in foreign policy through trade sanctions. We must, as a government, advance the position of U.S. agricultural products on the world market. This can be accomplished through the lifting of agricultural trade sanctions, aggressively negotiating the removal of EU trade barriers on biotechnologically enhance crops, ensuring the health of the emerging markets of Asia, and utilizing and strengthening the trade promotion programs of our government.

The greatest opportunity of the future is the development by agricultural producers of new and innovative marketing systems for their products. In August, two House Committee on Small Business field events were held to examine agricultural tax, regulatory, and trade issues that are critical to the agricultural community. At both of these events, an underlying theme surfaced from the witnesses-- the need and desire of producers to reach up the agricultural marketing chain and capture some of the profits generated by processing their raw commodities. It is clear that agricultural producers have an inherent innovative quality, and I was impressed that even during this time of extremely adverse pricing and production conditions, producers and farm organization representatives are still energized about looking for inventive entrepreneurial opportunities for the future.

It is clear that the future of our American agricultural system depends on these innovative producers and can be enhanced with the establishment of producer owned value-added enterprises. As we move into the 21st Century, it is my vision that U.S. agriculture, as the world's breadbasket, will remain strong and viable. But that the system will have to be improved -- through technology and entrepreneurial endeavors -- that will allow us to continue to grow "America's tomorrow's." I envision an American agricultural system in which agricultural producers **are the vertical integrators** and no longer totally rely on the existing highly consolidated agriculture marketing chain, or on the volatile world market. With this system, producers will be in the position where farmgate prices, effectively, have no meaning as their profit concern will be the soybean crush margin, the price of ethanol, and the pork or beef slaughter margin made by their processing plants.

The overwhelming consensus of farm groups at the Small Business Committee field events, was that more needs to be done to explore the development of this producer owned, vertically integrated marketing systems. That is the purpose for this hearing. From this hearing, I hope that the Small Business Committee will gain a further understanding of how the government can nourish the entrepreneurial fire of current and future agricultural small business owners without impeding their success. The testimony that will be provided here today will be invaluable to Congress in learning what the government should, should not, and can do to assist agricultural producers as they drive to develop the means in which they can reach up into the agricultural marketing chain and capture the true value of their raw commodities. By ensuring that the American agricultural system remain viable and becomes more profitable, we will "re-grow" rural America for generations to come.

Remarks of Missouri Farm Bureau President Charles E. Kruse
Before the U.S. House of Representatives Committee on Small Business
September 29, 1999

My name is Charles E. Kruse and I am a fourth-generation farmer from Stoddard County, Missouri, where my family and I raise corn, soybeans and occasionally cotton. I also serve as President of Missouri Farm Bureau, the state's largest general farm organization.

First, I want to commend Chairman Talent for his continued interest in empowering agricultural producers to take advantage of the benefits of adding-value to their commodities. Missouri Farm Bureau participated in both the field hearings conducted last month and we believe this Committee is determined to address the difficult issues we are facing.

This morning's hearing is especially timely as Congress is debating how to assist farmers and ranchers during the economic crisis we are facing. Let me assure you that it is indeed a crisis—the devastating combination of low prices and disastrous yields. Corn and soybeans are being harvested in Missouri and yields of 50 percent or less are all too common.

In the short-term, we must have economic assistance from Congress. Farm Bureau's top priority is getting economic assistance to producers in a timely fashion. We simply cannot have a repeat of 1998—assistance is needed now, not a year from now.

Economists at the Food and Agricultural Policy Research Institute (FAPRI) are projecting that farm prices will improve over the 2001-2002 period. However, until that time we can expect dismal prices to continue. Our goal is to help farmers hang on and government assistance is crucial.

Yet, government cannot be expected to solve agriculture's woes alone. There is no simple solution, we must have a system of policies and programs that allows our agricultural sector to prosper. This will require the cooperation of every sector including public, private and academia.

The purpose of this hearing, "Helping Agricultural Producers Re-Grow Rural America", is especially important. I have heard Chairman Talent highlight this issue during meetings in Missouri and we have heard the message loud and clear from our members. We recently held a series of six regional meetings around the state in which we listened to our members' thoughts on how the crisis is affecting their families, their farms and their rural communities. A common theme emerged from the meetings—we must look for ways to capture a greater share of the consumer food dollar.

Some states are already doing a very good job of this. New generation cooperatives have been formed to process commodities into products ranging from pasta to ethanol. These states have made a commitment. Missouri too is making this. The Missouri General Assembly provided a boost earlier this year by creating new incentives for producer-owned ventures. This will give us an important boost as our producers continue working to establish ethanol and pork processing plants.

But there is a void remaining. While interest in these new ventures is growing, little attention has been paid to the availability of technical assistance. Producers, and organizations alike, need access to information that will convert an idea into an enterprise. Where do we turn for product research, feasibility and marketing studies, legal assistance, and information on financing options? The information is available but it needs to be user-friendly.

Perhaps we should consider creating special teams comprised of representatives of state and federal agencies and colleges and universities. These teams could provide timely information on subjects ranging from financing options and environmental permits to tax incentives and equipment design. Ideally, a "cook-book" could be developed that interested parties could use to help jump-start the process.

At the federal level, we have a unique opportunity to assist producers. Earlier this year, Farm Bureau supported, and Congress appropriated, $145 million to the US Department of Agriculture's (USDA) Section 32 Fund. These funds were appropriated to provide direct cash payments to hog producers who continue to suffer from extremely low prices. Unfortunately, Secretary Glickman has announced that only $100 million will be paid in direct payments. If the remaining funds are not used for direct payments, we believe they should be used to fund programs that will encourage producers to add value to their products. For example, these funds could be used to provide grants to groups to assist with start-up costs. We are encouraging USDA to work with agricultural organizations to develop the parameters of such a program.

In Missouri, we have a group working to construct a new pork processing plant for independent producers. They could make good use of grant funds to assist with legal fees and other start-up costs.

Mr. Chairman, in closing, let me reiterate that encouraging producers to add-value to their products is a key to our long-term prosperity. We believe there is a need to: 1) establish diverse teams or entities to focus on the needs of those considering value-added ventures; 2) develop a "cook-book" that provides information on pertinent issues and available assistance; and 3) encourage USDA to use the remaining funds appropriated under Section 32 to develop programs to assist producers interested in adding-value to their products.

Agriculture remains the anchor of our rural communities and our nation will continue to reap the benefits of this relationship well into the future if we can simply "tap into the vein" of value-added processing.

Missouri Soybean Association

"Helping Agricultural Producers "Re-Grow" Rural America"
Small Business Committee Hearing
Jim Talent, Chairman
Rayburn House Office Building
September 29, 1999

Testimony of
Dale R. Ludwig
Missouri Soybean Association Executive Director/CEO

Good morning, my name is Dale Ludwig. I'm the executive director/CEO of the Missouri Soybean Association. The Missouri Soybean Association is a membership organization made up of nearly 2,000 soybean farmers from across the state. Our goal is to communicate issues facing soybean farmers and rural America to legislators at the state and national levels.

Congressman Talent, I would like to thank you and the committee for the opportunity to testify today.

Consolidation has taken place in the media industry, the computer industry and even the automobile industry. It is also impacting American agriculture.

Farmers are finding that as their marketplace becomes global, they must look to new solutions to remain competitive.

Just as corporations have found that they can join forces to increase economies of scale and remain profitable, farmers are discovering the same thing. Farmers are also uncovering that they can enhance their bottom line by extracting value from their products at more than one point in the delivery chain.

Farmers are adding value to their products. It started when poultry production companies like Tyson began vertically integrating their operation to receive profits at different points along the chain. The idea has spread to more segments of agriculture.

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Farmers are innovative. A group of producers in Northwest Missouri is in the planning stages for a soybean processing plant. It will give them another market to sell their soybeans. They will also profit as the soybeans are processed into soybean oil and soybean meal.

Other success stories are out there. There's a Michigan soybean processing plant owned by farmers that makes and sells its own motor oil. Two ethanol plants, owned by corn growers, are being built in Missouri. There are also groups of cattlemen, pork producers and rice producers in Missouri that are all trying to join forces to move their operations further up the marketing chain.

The catch is, bottom line, these farmers are experts, but experts in their own fields, whether that is raising hogs, growing corn or raising soybeans. These intelligent, hard working and innovative farmers are outside their arena when it comes to putting together processing plants. From looking at environmental site analysis, to determining the engineering components of a plant and even writing a business plan, these groups of independent farmers could use technical assistance.

Farmers are looking for ways to reach up the agricultural marketing chain and capture some of the profits generated by processing their raw commodities. I would like to see this small business committee assist farmers on the technical side of setting up these value-added endeavors. Helping farmers with things like business plans, engineering and site selection is the weak point in these joint business endeavors by farmers. Helping with technical assistance is a way to help rural America and farmers – America's original small business owners.

You are to be commended, Congressman Talent, for the leadership you are showing in this proactive approach to assisting farmers in their entrepreneurial spirit.

I would like to thank you again for this opportunity. I would be happy to answer any questions at this time.

Testimony of Gerald Tumbleson of Sherburn, Minnesota
Before The United States House Of Representatives
Committee on Small Business

Room 2360 Rayburn House Office Building

"Helping Agricultural Producers Regrow Rural America"

Mr. Chairman, ladies and gentlemen of the Committee, good morning. My name is Gerald Tumbleson of Sherburn, Minnesota. I am a Minnesota grain farmer and livestock producer. I recently completed a two-year term as President of the Minnesota Corn Growers Association, and I am a member of the Board of Directors of the National Corn Growers Association.

I am pleased to be here this morning to share my thoughts on how agriculture can help regrow rural American. In fact, I would like to add an element to our thinking on regrowing Rural America: how can we link farmers more closely to American consumers through value-added products and services?

I know personally both the challenge and the reward of developing value-added products in the agricultural sector. I am a member of several ethanol plants in Minnesota and a member of the new Phenix soybean processing plant. I helped to formulate a closed cooperative hog operation in my community.

Let me give you a brief look at one of the most successful agriculture value-added experiments in the nation. Ethanol made from Minnesota corn. In less than a decade Minnesota farmers have built annual product sales to 200 million dollars.

There are 11 farmer-owned ethanol plants in Minnesota. These plants are owned by 8,000 Minnesota farm families. My family is one of them. Ethanol is blended in approximately 98 percent of all gasoline sold in Minnesota. This market for ethanol creates jobs and opportunities for farm families. The market results in the production of well-paying jobs and attractive co-products.

As you may know, ethanol reduces harmful air emissions from carbon monoxide by up to 25 percent. Minneapolis, after failing Clean Air Act requirements for many years, began to meet these requirements when ethanol was blended into a majority of Minnesota gasoline. For the last five years, as ethanol market penetration increased, the Twin Cities consistently has met clean air requirements for carbon monoxide.

Four of five Minnesota drivers in studies done by the Minnesota Corn Growers Association, supported the use of domestically-produced, renewable fuels like ethanol.

Building on this enthusiasm and success, there are now dozens of closed or "new-age" coops in operation.

That's our success story in Minnesota. Let me briefly address the opportunities for value-added agriculture.

Value-added agriculture simply means farmers and rural communities using their commodities to make products consumers will buy and use. It's more than reducing intermediaries between the farm and fork.

It's realizing the advantage of owning the raw commodity producing a variety of market-ready consumer goods. Corn alone can be made into 3,500 products, from food to medicine to clothing. In fact, the shirt I have in front of me on the witness table is made from corn. I am going to pass it around for the committee to examine.

How would any of you like this manufacturing plant in a small community in your district? At the moment, these shirts are made in Japan. Wouldn't it be great if we could stimulate value-added, locally owned industries like this in each of your congressional districts.

Let's start with rural communities. Value-added industries bring excitement to rural communities. The national discount stores, like Walmart, displace workers from one job to another in a small community, pulling its retail profits to large money centers. I won't say they drain the town, but they certainly do not put back into the community what they take from it.

Value-added industries bring new people with specialized skills in manufacturing, distribution and marketing into small communities. Value-added industries allow our local people the opportunity to learn new skills, in new jobs, and stay in the community. They engage businessmen, truckers, professionals, employ scientists, as well as laborers. They bring excitement to the community. They revitalize it. They bring hope for a stronger, stable rural economy.

Moreover, the value-added industries offer farmers a way to capture more profit from his product. It helps stabilize his income. This stabilization comes from diversification, which spreads risk. Ultimately, this will result in less dependence on government as the stabilizing economic force for farmers and rural communities.

When grain prices drop, so does the cost of making a gallon of ethanol and other value-added products. Either way is fine for the farmer. With higher grain prices, there is potentially lower profit in value-added products, and with low grain prices there may be higher profit in value-added products. Value-added industries provide a permanent long term solution in the market place for farmers, and for society.

When we go into the market place we have competition. And in a well-developed, highly efficient economy such as ours, you've got to provide a better product with more value than all competitive products available to consumers.

The automobile fuel interests in Minnesota did not willingly give up $200 million in annual sales because of philanthropic motivation to help farmers or rural communities. They gave it up because we had a better product that drivers wanted to use to fuel their cars.

Our challenge--as is all providers of product and services--is to provide a better value, where consumers want it delivered.

Farmers must develop a new way of thinking about their products. They must come together to form entities that are different from what they have known in the past. They will struggle with new and different rules. And the market place will give them no slack.

I believe there is a legitimate, limited role, for government in the incubation of value-added industries. State and federal government has supported the development of these new ethanol plant, along with the eight thousand Minnesota farm families have contributed to ethanol plants. That's a success story.

A modest amount of money to provide a helping hand--not a hand-out--will give the dividend of economic renewal to farmers and to rural communities. Here's how government can best help.

First, provide the missing link in the process. It takes a long time for farmers to come together because there is no infrastructure to facilitate the development of the value-added business.

While there are currently a number of government funds, such as the Rural Economic Development Fund, the Agriculture Utilization Research Institute and others, there are missing links to the new product development process. Government can fill these missing links.

There must be a central point for rural communities and farmers to coordinate the financial and human resources with those of government. Government serves as catalyst and facilitator. Farmers and rural communities can own the enterprises.

Our experience in Minnesota can be duplicated in every rural community in America, with literally hundreds of products. High quality paper can be made from corn stalks. Durable floor tiles from soybeans. Sophisticated medicines from most grains. The list is endless, and so will be the benefit to rural America.

Thank you for your time today. I am pleased to take any questions the committee has for me.

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Testimony of Jeff Ward
on Behalf of the National Pork Producers Council

Before

The House Committee on Small Business

On

Helping Agricultural Producers "Re-grow" Rural America

September 29, 1999

National Headquarters
P.O. Box 10383 • Des Moines, Iowa 50306 USA • (515) 223-2600 • FAX (515) 223-2646

The Other
White Meat.

Chairman Talent and Members of the Committee:

My name is Jeff Ward and I am the Director of Producer Education for the National Pork Producers Council (NPPC). I am here representing the NPPC, it's 44 member state organizations and America's pork producers. As Director of Producer Education, I have spent a great deal of time the past two years studying how producers can become involved in value added agriculture.

U.S. Pork Industry

According to a recent Iowa State University study conducted by Otto and Lawrence, the U.S. pork industry supports an estimated 600,000 domestic jobs and generates more than $64 billion annually in total economic activity. With almost 11 million litters being fed out annually, U.S. pork producers use 1.065 billion bushels of corn valued at $2.558 billion. Feed supplements and additives represent another $2.522 billion of purchased inputs from U.S. suppliers which help U.S. soybean prices, the U.S. soybean processing industry, local elevators and transportation services based in America's rural areas.

Economic Outlook

In early February, NPPC testified before the House Agriculture Committee that hog prices dropped below $10 per hundredweight on December 21st, for the first time since 1955. Adjusted for inflation, hog prices were lower in December of 1998 than they were during the Great Depression. Pork producer financial losses were staggering in 1998. Data from the University of Missouri suggests the producer sector as a whole lost $2.6 billion in equity in 1998 and may lose another $1 billion in 1999.

The recently released USDA Hog & Pigs Report, offers some potential for some price improvement in 2000.

What Is The Potential For Producers to Take Part In the Profits Generated from Processing Agricultural Products?

1998 saw pork producers receive their smallest percentage of the consumer dollar in history. An increased supply of market hogs combined with reduced slaughter capacity created a disastrous economic situation for producers. This happened during a record year for pork consumption. As this crisis unfolded, it became apparent, the the dollars in the pork chain were at or near the consumer.

Current producer Value Added programs are primarily located in market periphery areas or concentrate on a single product (i.e. country cured hams). In most instances the initiatives were started due to conventional market access problems or a hobby turned into a business.

The typical production model for pork producers is shown below:

Pigs = Feed + Building + Management + Variation

In this model, producers in some form or fashion, could control the feed, building and management inputs. While variation commonly occurs, it can be minimized through SOP's, genetics and other management factors. In the 90's pork production model, most everyone had access to the same technology, genetics, feed, etc. The only competitive advantage a producer could reasonably attain was through building a better mouse trap in one of these areas and typically it wasn't long before the rest of the industry caught up.

Some would argue that marketing/pricing is an issue in pig production, however unless due to market access problems due to geography, most producers have access to the same market options and prices.

As stated earlier, under the present production model, any progressive producers has access to the knowledge and technology to be competitive producing pigs. Under a market (consumer) driven model this is quite different. Value Added initiatives call for a market driven model.

Market Driven Model

Sales = Consumer + Product Development + Error (Variation)

Unlike the production model, there is much variance in each component of the equation. In the consumer alone, variation can be due to preferences, lifestyle, culture, buying power and population density. Also the exchange of knowledge and technology is much more closely guarded.

While developing the Front End Guidance for Value Added Networks manual, Dennis DiPietre and Brian Buhr noted:

> "The individuals and firms who interact directly with consumers will have the greatest potential to develop knowledge of consumer demands and ability to pay. Consumer preferences are enlarging beyond interest in physical characteristics of the product, such as lean, color and taste, to such things as safety, humane growing conditions and organic production methods. As this occurs, the information flow from consumers necessary to drive investment, will need to reach through the chain all the way back to pork producers and their input suppliers. Feedback stopping at the local meat case manager will not be sufficient to guide future investment."

> "While it is not clear which mechanisms will arise to accomplish the necessary knowledge-sharing and information transfer, it is clear commodity price determination mechanisms are unlikely to be effective in conveying demands for specific, identity-preserved products or attributes. The response will increasingly be to seek and develop vertical relationships to augment price signals."

In order to capture a greater portion of the consumer dollar, it is imperative that producers participate in the activities which make pork a consumer friendly product. This is a distinct shift from the commodity production mindset of the past.

In 1997, a study was completed by Dennis DiPietre and Brian Buhr. The study was funded to determine if there were truly unmet or underserved pockets of demand. Much effort has been spent on the development of export markets. One of the goals of this study was to determine the viability of "domestic export markets."

In other words, are there differentiated preferences for pork among ethnic groups, and if so, how do you identify and capture those preferences. Also, should difference be discovered, there could be important implications in developing export markets.

Numerous ethnic groups exist across the United States. The Hispanic community represents the fastest growing ethnic group in both population and disposable income. Therefore it was selected for study. Results of the study are too numerous to discuss here, however the results can be found the NPPC publication "Front End Guidance for Value Added Networks." The study showed quite conclusively, that the Hispanic (Mexican descent) consumer prefers many different cuts which require carcass breaks not found in the current commodity market. The study also indicated a willingness by Hispanic consumers to purchase additional quantities of pork when provided as they desired.

The results of the project provided very direct insight into market access of the Hispanic consumer. But more importantly, it exhibited that there are potentially many pork chains based on consumer preferences and it also provided a tool to discover where those opportunities are.

The project pointed out there indeed are unmet pockets of demand (market niches) that are currently under served or not met by the current commodity pork marketing system. In many cases, the markets are viewed as too small to be served by the current marketing system. These markets however represent a tremendous opportunity to individual producers or groups that are committed to adding value to there production.

An excellent example of this is currently underway in Utah. Utah cannot be classified as an ethnically diverse state by any measure. In 1997 a group of small, independent producer, driven by lack of market access, began selling pork to Hispanic markets in the Salt Lake valley. From their modest beginning, they now market 44,000 head per year directly to retail outlets. Through this effort, they were able to maintain economic viability during the December 1998 price crisis.

They were able to access this market by providing retail outlets with pork fabricated as the customer preferred. Due to the specialized nature of the cuts and their distribution system, they are able avoid competition and expand market share.

In summary, it is possible for producers to successfully enter into value added ventures. It must however be done for the right reasons. Market access further up the pork chain, must be the driver. Very few producers will be able to extract premiums from the market place. However producers must be able participate in the pork marketing chain and capture a higher percentage of the consumer dollar.

This will require a mindshift from pig production to meat production that fulfills consumers needs and wants. It will also require an entrepreneurial spirit not currently found in most of production agriculture. Training will be required to help producers in business planning, startup, finance and operations to make these ventures successful.

What Are The Barriers To The Creation Of Producer Owned Value-Added Processing?

There are two primary barriers to entry for producers interested in value added processing. They are knowledge of the marketing process and access to capital for startup and operation.

As was stated earlier, producers are very good at producing hogs, but have limited knowledge past the farm gate. The current commodity marketing system, has not required the producer to acquire knowledge of consumer demand. The packer typically adjusted pricing grids to force any changes demanded by the market place.

As producers begin to explore how to create value added ventures, many become discouraged due to the lack of resources available to assist them. If resources (i.e. consultants) are found many times they are very expensive. Very few good resources, both technical and financial, exist to assist producers in business planning and management, and market research.

The second barrier to entry for many producers is access to captial to fund such ventures. Many conventional sources of capital (such as banks) have little experience in dealing with these ventures. Because of this, many are reluctant to fund such ventures without high equity input or loan guarantees. Additionally, outside sources, such as federal loan guarantee programs are both cumbersome and time consuming to work acquire.

New generation closed coops have become very popular recently. The access to capital issues noted above, are also experienced by the coops. The recent economic crisis in the pork industry, has also limited producers ability to fund start up equity for a closed coop.

What programs Are Needed To Encourage And Assist Producers To Establish Value Added Enterprises?

To paraphrase an old saying; If you feed a person a fish, they eat once, if you teach a person to fish, they will eat for the rest of their lives. Any programs offered, educate producers about value added ventures as well as provide technical and financial assistance in the formation of such activities.

Technical and cost-share assistance in forming value added coops and conducting economic analysis and feasibility studies for such ventures is needed. These studies provide the road map and plan for the business. NPPC recently completed case studies on three successful value added pork marketing businesses. Without exception, each had a well thought out business plan which addressed all phases from production to marketing.

The previous section noted access to capital is a limiting factor to producers. By providing access to loans, grants and guarantees for feasibility as well as startup, producers will have an opportunity to determine their future in the pork industry.

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WRITTEN COMMENTS

SMALL BUSINESS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 29, 1999

VIRGIL J. FLANIGAN
PROFESSOR and DIRECTOR

Introduction

These comments are based on our experiences in developing new technological avenues for the use of soybean-based products. 'Our' refers to the University of Missouri-Rolla in general and to the Center for Environmental Science and Technology's in particular. The most important point that we have come to realize is that an integrated approach is essential to produce competitive and environmentally friendly products that will have a real market impact.

Discussion

Technology development has been the primary focus of research at the University of Missouri-Rolla for many years. The Center for Environmental Science and Technology was set up to facilitate interaction among industry, academia, and government agencies to develop environmentally friendly and competitive products for the marketplace. A few years ago, administrators of the soybean check-off fund in Missouri contacted us to direct our attention toward soybean-based products and their utilization in technical applications. This has resulted in a number of projects, and I will discuss a few of these.

<u>Obscurant Smoke for Military Training</u>

Fort Leonard Wood, a major engineering training facility for the US Army, is located about 25 miles southwest of the UMR campus. Recently, the Army's chemical weapons school moved to Fort Leonard Wood, bringing with it a perfect opportunity to investigate the use of soy oil as a replacement for the petroleum-based fog oil currently in use. Missouri farmers and locally-based small businesses could provide a product to the school that will meet or exceed the Army's specifications for fog oil without relying on fossil fuels. In fact, our investigations have shown that soy oil is the only substance that meets the specifications at a lower cost. In addition, the research shows that use of these materials will provide improved performance. It goes without saying that using this renewable resource provides an economic advantage to Missouri farmers and to the Army. Through experimentation, we have found that soy-based fog oil contains no polycyclic aromatic hydrocarbons (PAHs) and provides better cover against infrared imaging, thus reducing the need for graphite to produce the same effect. The fog oil currently in use contains PAHs.

Soy oil has been shown to offer several advantages over petroleum-based oil:

- lower cost
- bio-degradability
- economic multiplier of using local products

Our studies have shown that, of all vegetable oils investigated, soy oil was superior in performance for producing obscurant smoke. The annual use is approximately 250,000 gallons per year, representing approximately 200,000 bushels of soybeans. Even with these positive results, the commercialization (i.e., Army acceptance) is slow and difficult. The Center must have a broad base of technology, commercialization, and business expertise, along with the insight of the farm organizations participating in the program, to be successful and to overcome the obstacles. The project must do more than simply produce increased demand. The project must provide a means for the participating farmers to share in the value-added profit.

Paint Additives and Esters

We are presently working on soy oil derived paint additives. These additives lower the use of petroleum-based solvents, thus reducing hazardous volatile organic carbon (VOC) emissions during the painting operation. The patent application is filed for this development, and transfer technologies are being discussed with several companies. There are several approaches to commercialization that will improve farm economy. One such approach involves reducing the technology fee to Missouri farmers. We also have the opportunity to negotiate contracts with manufacturers to sell a substantial ownership in the plant to the participating farmers. The production of the additive will enhance the production of methyl esters (bio-diesel) in Missouri. We are developing a number of other soy products for use in polymers and high-strength composite materials. These products expand the potential for profit and economic stability to the participating farmers.

Selective Soy Oil and Meal Separation

We are developing new processes for selective separation of soy oil constituents and meal. Currently, soy oil processing is based on the use of hexanes as a solvent in removing the oil from flaked grain. The oil then in solution in the hexane must be removed by distilling the mixture. The process is non-selective and requires substantial post-extraction processing, including distillation, which makes the overall process costly and energy-intensive. We have developed a new solvent extraction system that eliminates the need for distillation and post-extraction processing. The solvent is also more selective by leaving the lipids in the meal, eliminating the need to de-gum the oils. The process has a large potential for cost reduction. The meal energy content is improved as well due to the increased fat content. Again, the farmers will own the technology, and the control of the contracts can provide many different approaches to shared profits.

There are several other exciting projects underway that provide many opportunities to farmers and other small businesses:

Technical oils

Production of superior oxidation-resistant oils for use in transformers and other electrical devices

Lubricating oils

System for using vegetable oils in machining provides improved machined surfaces and clean chips

Ester production

New esters for improved polymer performance

Composite production

New composite resins using special esters to provide improved properties

Polystyrene recycling

Used and scrap polystyrene can be dissolved in soy esters and reprocessed to produce new polymers and other products.

Foam

Foams can be formulated with de-oiled soy meal.

Rice hull

Carbon and silica can be derived from rice hulls and used in improving the mechanical properties of polymer products such as tires.

Several Others

The products being investigated and/or developed are, for the most part, replacements for petroleum based chemicals. They have several important environmental characteristics such as being renewable and biodegradable, but these characteristics can not be substituted for good economics. We almost always require an economic advantage in a new product unless we have very special circumstances.

Innovation Centers

Hopefully, the innovation centers will be set up to help provide the expertise and direction required to provide the agricultural producers with the technology, scientific information, and support needed to maintain leadership and success in the agricultural industry. The centers will provide information, technical assistance, and training in processes using agricultural products. The centers will be capable of providing science and engineering requirements for developing products, including the detailed economics of full-scale manufacture or plant operation. The centers will be capable of feasibility studies, business planning, financing, and expert business decisions. The centers will be aware of business opportunities both public and private and capable of bringing groups together to take advantage of available opportunities.

Summary

The discussion of this type of center brings up all kinds of possibilities for enterprising farmers and businessmen. It is exactly this excitement and the positive direction supported by a strong business and science center and the wisdom of the supporting organizations that will make a difference in the agricultural communities across the state. We certainly support the adoption of this approach and center.

Virgil J. Flanigan, Ph.D., P.E.
Director

Federal Contracts:

"Multidisciplinary Research in Mine Detection and Neutralization Systems." Supported by Army Research Office; 12/1/97 – 11/30/02; $5,000,000.

"Development of a Particulate Matter On-line, Real-time Physical and Chemical Characterization and Monitoring System." Supported by the US Air Force and NASA through a contract with Deposition Research Laboratories, Inc.; 4/1/98 – 3/31/00; $1,000,000.

Testimony on

"Helping Agricultural Producers "Re-Grow" Rural America

Congress of the United States
House of Representatives
Committee on Small Business

September 29, 1999

By

Dr. Nicholas Kalaitzandonakes
University of Missouri-Columbia

For decades, there has been an unmistakable trend of gradual technical intensification in agriculture. Increased technical sophistication has made agriculture one of the most productive sectors of the US economy. Productivity gains have been largely transferred to the consumers in the form of cheaper and safer food supplies. In the 1990s, however, technical intensification in agriculture entered a new era.

Radical innovations with capacity to transform entire production and distribution systems -- like biotechnology, global positioning systems (GPS), remote sensing and other site-specific production techniques as well as the Internet and e-commerce-- have all entered the market in just few years apart. This rate of technical innovation has no historical precedent. As we stand in front of the new millennium, it is unlikely that we can fully anticipate the economic and structural impacts of these innovations on the agrifood system. This is not only due to our lack of historical perspective but also because interactions among these radical new technologies are spurring innovation at ever-increasing rates.

Knowledge of biological systems gleaned through biotechnology and other more traditional technologies, detailed environmental information from GPS, and electronic market intelligence from consumers and suppliers, all traveling through the internet, are being connected and leveraged into an increasingly efficient and environmentally rational agrifood system. These are not futuristic models. They are being implemented as we speak and they are ushering agricultural production, processing and distribution into a new era. An era where value is added in the agrifood sector by substituting knowledge for energy, chemical pesticides, unneeded inventories and manufacturing processes.

Distributing value added in the emerging agricultural sector

As in the rest of the economy, an increasing share of the value added in a knowledge-based agriculture will be distributed to the owners and the managers of the knowledge assets (know-how, patents, market intelligence, etc.). In my opinion, the key question being asked in this hearing is whether farmers will be empowered to participate as equal knowledge partners in the emerging agricultural sector, or, whether they will be left to claim a progressively smaller share of value added from land ownership and care taking.

Of course, individual farmers do not have the capital resources or scale to invest in expensive research and development (R&D). Collectively, however, farmers not only can invest in targeted innovations that enhance their competitive position in specific production systems but they may also organize to capture added value from downstream activities. In some cases that may imply forming new generation coops and processing their raw material through innovative and differentiated proprietary processes. In others it may involve organizing in closed supply networks, coordinated through innovative contracts to secure premiums from downstream partners. Yet in others it may simply involve capturing value through licensing of proprietary technologies to a capable third party.

The key is to engage farmers in the transformation of agriculture as inventors, as investors and as managers of innovation. Land Grant Universities can be capable partners continuing their long tradition of generating technology and market intelligence that relevant to their constituency. Private sector partnerships may also be productive.

Managing innovation and value added through technical assistance centers

There are some key lessons about managing innovation and knowledge assets that must not be lost in this discussion:

- Management of innovation is an *organizational* problem
- To capture added value from innovation an explicit strategy for exploiting the competitive advantage created must be in place
- Successful innovators excel at *managing linkages* within and between organizations

Clearly, such outcomes are difficult to achieve by loosely coordinated groups of farmers. In my view, some form of a technical assistance center would be called to effectively address these issues and chaperon farmer-led innovation initiatives towards productive and efficient outcomes. Accordingly, the proposed centers may act to:

- Coordinate or execute proprietary applied engineering and other R&D
- Perform feasibility studies and market analyses
- Help interested groups formulate relevant strategies and business plans
- Provide assistance with business and organizational design
- Identify existing people and financial resources and facilitate linkages through contacts, planning, grant writing, etc.

If organized appropriately, agricultural technical assistance centers should lead to sustainable income improvements for US farmers with the well-known multiplier effects for rural communities. Furthermore, they will advance economic efficiency, as returns on public investment in agrifood innovation remain extremely high, and, a large portion of such returns accrues to the consumer.

Short Vitae

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Education

- University of Florida, PhD, Agricultural Economics, (1990)
- University of Florida, MS, Agricultural Economics, (1987)
- Agricultural College of Athens, Greece, B.S., Agricultural Economics, (1985)

Professional Experience

- Visiting Professor, The Monsanto Company, (1998)
- Associate Professor, University of Missouri, Columbia (September 1996 – present)
- Assistant Professor, University of Missouri, Columbia (September 1990 - 1996)

Other Professional Experience

- Editor, *AgBioForum* – an on-line magazine on the economics of agrobiotechnology
- Editorial Board Member, *J. of Agricultural and Applied Economics* (1996-present) & *Review of Agricultural Economics* (1993-1996)
- Consultant to national & international public organizations (USAID, OECD)
- Consultant to agrifood firms and industry associations

Teaching Experience

- Agricultural Economics 301, *Economics and Management of Innovation*
- Agricultural Economics 485, *Decision Support Methods and Tools*
- Agricultural Economics 424, *Advanced Production Economics*

Research

Selected Publications on Economics of Biotechnology

Kalaitzandonakes, N.G. (in press). Biotechnology and agrifood industry competitiveness. In W. Amponsah et. al. (Eds.), *The Competitiveness of US Agriculture*. Hayworth Press.

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Bureau, J.C., and N.G. Kalaitzandonakes "Measuring Effective Protection as a Superlative Index Number: An Application to European Agriculture." *American Journal of Agricultural Economics* 77: 279-90, 1995.

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"Management Scenarios: Agrobiotechnology in the EU", *Farm Foundation*, $10,000, 1999

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House Committee on Small Business
Hearing:
"Helping Agricultural Producers "Re-Grow" Rural America"

Testimony from Rodney G. Christianson, Chief Executive Officer
South Dakota Soybean Processors, Inc.
Volga, South Dakota

Mr. Chairman and fellow members of the House Committee on Small Business, thank you for the opportunity to speak to you today concerning "Helping Agricultural Producers "Re-Grow" Rural America".

I am Rodney Christianson, Chief Executive Officer of South Dakota Soybean Processors, Inc. (SDSP), a direct producer-owned new generation cooperative built by 2,100 farm families located primarily in Minnesota and South Dakota. Our goals are to add value to our members' soybeans, to maintain a financially strong business unit, and to return a maximum value added patronage to our members annually. From a dream conceived in 1992 for farmers to process soybeans into high quality soybean oil and soybean meal, to the end of SDSP's third operational year which ended this August 1999, SDSP has:

- Raised over $21 million from farm families to build their dream.
- Added value to 60 million bushels of producers' soybeans.
- Re-invested or committed additional capital in excess of $20 million.
- Generated $175 million of economic activity in rural America.
- And to SDSP's core principle, we will have returned $9.2 million dollars in cash patronage to our members.

SDSP's 2,100 farm families and hundreds of other producers in Minnesota and the Dakotas have demonstrated by their cooperative actions that they believe 1.) it is possible for today's U.S. agricultural producer to participate in and find success in value-added processing, and 2.) for future viability, today's producer needs to capture a larger and more equitable share of the food dollar thereby adding value to the commodities they grow.

I will speak to you today about the barriers of creating a producer-owned, value-added processing facility, the types of programs that encourage and assist producers in establishing new value-added cooperatives, and finally, the type of assistance needed by existing value-added cooperatives to ensure a level playing field with its competitors. If it is the desire of this Committee and Congress to create an environment that encourages the American agricultural producer to participate and capture a larger and more equitable share of the food dollar, your assistance should target the following items:

- capital formation,
- producer education and resource centers used as an information clearing house, and
- protection against potential anti-competitive or near monopolistic practices of industry giants.

From conception, for producers to create a value-added processing venture, their core leadership must be totally dedicated to the project by giving freely of their time and other resources. This core group must navigate through, at times, seemingly insurmountable obstacles. These challenges include the following:

- overseeing the development of a feasibility study and business plan,
- creating a capital formation plan (securities laws vary from state to state),
- developing an organizational structure for the cooperative, and
- having the ability to attract a large number of producer members to provide both the commodity to be processed and capital to build and start operations.

Outside Minnesota and the Dakotas, the agricultural producer has not been widely exposed to ownership of value added processing. However, once producers are familiar with a successful project, it appears they will seek other value-added opportunities. In SDSP's experience, raising equity in Minnesota was an easier task due to previous success Minnesota producers found in value-added processing. Today, a new South Dakota value-added ethanol venture credits their success in raising capital on SDSP's early operational successes.

Investment in value-added processing requires "outside the box" thinking by the producer. Likewise, the core leadership needs managerial skills outside their core competencies. Programs targeted to assist producer education, development of regional resource centers, and seed money for feasibility studies would create an environment that encourages new value-added processing ventures. After all, it is during the feasibility study phase that individuals or corporations who might work for the demise of the project (along with cautions from well-meaning naysayers) will be heard. The project's core leadership and potential producer investors will be told all the reasons that their project is destined to fail. Leaders and producers need to be equipped to make solid, informed and confident decisions to proceed or not to proceed.

Once the conception of a new value-added venture has taken form and its leaders committed, capital will be required. A cooperative being under-capitalized is one of the top reasons for failure. Value-added processing is capital intensive, cyclical in nature (both in commodity price risk and margin structure) and highly competitive in an ever-consolidating corporate world. If Congress had to choose only one method to assist agricultural producers entering value-added processing, I would strongly urge you to assist with capital formation.

The use of low interest and loan guarantees for individual producers to purchase cooperative stock would encourage greater participation in new value-added ventures. Likewise, low interest and/or loan guarantees directly to the cooperative would also encourage producer participation. Over the last year, a $200 million Cooperative Stock Loan Program was available from Rural Development. The program provided lenders up to 80% loan guarantees on purchases of new value-added cooperative shares. Well intending as this program may have been, one needs to question why this program was not utilized at any measurable degree. It is my understanding that the complexity of this program prevented lenders from participating.

Simplifying the "red tape" requirements of funding availability is essential if Congress truly desires to implement successful assistance programs. Producers realize that safeguards need to be in place for the protection of the environment and the integrity of the program(s), but with a realistic balance. Specifically with the Cooperative Stock Loan Program, SDSP requests that the "new" cooperative qualification be dropped from the program requirements. Unlike the old cooperative system of returning just 20-30% of members' patronage in cash to its patrons, new value-added processing cooperatives return a much higher portion of its profits to its patrons in cash annually. SDSP has returned in excess of 70% of its profits in cash to its members. Therefore, should SDSP desire to expand into another major project, our existing members (and/or new members) will be required to provide additional capital to this cooperative. It only makes sense to support value-added ventures as a whole, whether a "new", higher risk cooperative, or a proven, stable and successful cooperative.

As you explore options Congress can consider to encourage today's producer to invest in rural America's economic development and to be the economic engine to "Re-Grow" rural America, take a moment to reflect on the producer. We are asking this producer to invest during this time when their core business is suffering 20 to 30 year lows in commodity prices. We are asking this producer to invest during this time when the food industry trend is consolidation and global marketplace pressures. We are asking this producer to invest during this time when rail transportation systems, a major economic success/failure factor for value-added processing, lack viable competition in most transportation corridors and have their systems running at or near capacity. In the eyes of today's producer, these reflections are daunting. So when today's producer does invest in value-added agriculture to help "Re-Grow" rural America, that producer needs assurances that the competitive environment will afford an opportunity for an equitable return.

I am confident that the U.S. producer who invests in value-added processing is willing to compete fairly in their chosen industry. The question I would raise is, will Congress be willing to provide a level playing field for producer-owned ventures against the industry giants in the food and transportation industry? Many producers will have severe reservations about anti-competitive actions by industry giants. This is the last critical component needed to encourage producers to make the final step.

For example, SDSP's business strategies rely on soybean meal rail shipments to market a good portion of our business. We believed that our location and corresponding investments gave SDSP a competitive advantage to be the high quality, low cost supplier to our markets. Although SDSP is serviced by Dakota Minnesota & Eastern Railroad, a short line carrier, the Burlington Northern Santa Fe (BNSF) is the primary mover of SDSP's soybean meal shipments. And as such, the BNSF has established SDSP's railroad rates for the vast majority of our soybean meal shipments.

The BNSF's methodology in determining rail rates is market-based and not based on the cost of providing service to a shipper. Their justification is that their system provides the end customer competitive alternatives in purchasing soybean meal. SDSP believes this system simply allows the BNSF the opportunity to maximize their own revenues by increasing the cost of low priced soybean meal to an average price, so that their customers really have only one average price to consider. It is the hope of BNSF that they have established a rate structure for SDSP that allows SDSP to continue to service the market while the BNSF receives higher revenues per loaded mile shipped. The increased profit margin for each loaded mile needs to be paid for either by SDSP or SDSP's customer.

New rates implemented by the BNSF in September 1999 have changed the relationships among several soybean processors served by the BNSF. I have chosen Sweet Grass, Montana as a destination point as an example where the BNSF rate changes have adversely effected our business partnership:

1. Council Bluffs, Iowa to Sweet Grass has the longest transportation distance at 1,275 miles. This trip shares the lowest shipping rate at $1,755 per rail hopper car with Lincoln, Nebraska, the second longest shipping origination point.

2. SDSP's new shipping rate is set at $2,250 per rail hopper car, yet our shipping distance is only 1,063 miles. Although the BNSF shares SDSP's shipping revenues with the DM&E for their services provided, SDSP contends that the cost to BNSF for the DM&E's service is cheaper than BNSF's cost of providing similar services directly to SDSP.
3. SDSP's shipping rate to move a load of soybean meal to Sweet Grass will be $2.12 per mile. SDSP's competitor at Council Bluffs enjoys a shipping rate of $1.38 per mile. SDSP's cost is 54% higher per mile!

These tactics compromise the investments made by SDSP's producer members-those same producers we are targeting to make more investments in this industry where there are currently no protections against monopolistic practices. Where railroad competition exists, these rate disparities do not exist.

The other challenge we have experienced as a producer-owned, value-added cooperative occurred in Chicago. On January 1, 2000 the Chicago Board of Trade (CBOT) will implement three changes to the Soybean Oil Futures Contract. Although this issue is very complex and not the focus of today's forum, I have included the text portion of SDSP's comments filed with the CFTC with my written testimony.

One of the three changes singles out and targets SDSP, totally unaffecting the other 40 delivery locations. The rule change is completely anti-competitive and will, again, negatively impact our members' earnings in excess of $1/2 million each year. SDSP is grateful for the support we have received from legislators, including Congressman John Thune. With this support, concessions in implementing the new rules, including a grandfather clause, will minimize the initial impact on SDSP.

SDSP's major concern is that a self-regulated, highly influential organization such as the Chicago Board of Trade was able to receive approval on what we consider a highly anti-competitive rule change by the Commodity Futures Trading Commission, a government agency designed to provide oversight and protection.

The process utilized by the CBOT in establishing the new rules and seeking approval by the CFTC was highly disturbing to SDSP. It is our belief that the CBOT began with the foregone conclusion that perceived problems in the soybean Oil Futures Contract delivery system was solely related to the entrance of SDSP. Since the problem was already identified, the approval process inherently led to rule changes that would attack the problem and avoid or ignore any information to the contrary. The CBOT has implemented rule changes anti-competitive to one facility and has not corrected the basic problem of the system.

As the process started, the CBOT searched out rule changes that would lower the maximum delivery capacity at the Volga facility and to make a significant reduction in the value of the oil delivered by SDSP. The following actions provide a quick overview of the items leading SDSP to this conclusion:

- Only one study was conducted by the CBOT staff, concluding that the soybean oil contract and automatic differential system was performing as designed and was successful. The CBOT chose to ignore this data.
- An Oil Task Force was commissioned to provide the design of the rule changes needed. A review of the minutes of the Oil Task Force meeting on

October 21, 1998 reveals that the CBOT members and Task Force members clearly targeted SDSP.

- In the CBOT's submittal for approval to the CFTC, the CBOT consciously chose to skew the historical data to better position their arguments for their proposed rule changes.
- Also in their submittal to the CFTC, the CBOT provided data that demonstrated no reduction in authorized certificate capacity should occur at Volga, SD. Yet, their submittal proposed a 40% reduction in authorized certificate capacity.

Again, I am confident that the U.S. producer who invests in value-added processing is willing to compete fairly in their chosen industry. But let us be realistic at the same time. The business and profits captured by the agricultural producer will be considered business and profits lost by major competitors.

A successful campaign to urge producers to invest in value-added agriculture and help "Re-Grow" rural America will include assistance with the following items:

- capital formation,
- producer education and resource centers used as an information clearing house, and
- protection against potential anti-competitive or near monopolistic practices of industry giants.

On behalf of SDSP's 2,100 farm families, I want to thank you for this opportunity.

"Helping Agricultural Producers "Re-Grow" Rural America"

Rodney G. Christianson
Testimony Attachment

SOUTH DAKOTA
SOYBEAN
PROCESSORS

February 24, 1999

Ms. Jean A. Web
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21 St. Street, N.W.
Washington, D.C. 20581

Dear Ms. Webb:

South Dakota Soybean Processors, Inc. (SDSP) recommends the following action to the C.F.T.C. regarding the Chicago Board of Trade's (CBOT) proposed amendments to its soybean oil futures contract:

1. Approve CBOT's proposed amendment to Regulations 1141.01 (f) - (l). Automatic Adjustment Differentials double from a maximum of 10 cents per hundred weight to 20 cents per hundred weight. The proposed amendment to double the automatic adjustment delivery differential should address the concerns of the taker of the soybean oil contracts and make the system more responsive to changing market conditions.

2. Approve CBOT's proposed amendment to Regulations 1180.01 (f) - (k), contingent upon CBOT allowing SDSP to register SDSP's daily load-out rate at 30 for jumbo tank cars (152,500 pounds) and the daily load-out rate at 60 for trucks. SDSP has already demonstrated to the CBOT that its rail load-out capability in a twenty-four hour period is substantially in excess of these requirements. SDSP would recommend rejection of this proposed amendment if this contingency cannot be agreed to by the CBOT. The CBOT rejection of SDSP's load-out rate would confirm that the amendment was formulated to specifically force a reduction of SDSP's regular capacity.

3. Reject CBOT's proposed amendment 1180.03, Freight Charges to Nearest Class I Railroad Interchange. The proposal seeks to isolate SDSP as a separate delivery territory with its own differential to the soybean oil future contract. This proposal is anti-competitive and adversely targets SDSP.

If the C.F.T.C. approves the above proposed amendments in their entirety, individually, SDSP will suffer the consequences of anti-competitive action by the CBOT. The investment of SDSP's

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2100 farm families would be compromised. Industry giants will be armed with yet another weapon to stop the trend of producer involvement in value-added agriculture.

The C.F.T.C. has been given power from Congress to protect the "public interest" under Section 5 (7). In effect, the C.F.T.C. has the power to alter contract market rules to protect the "public interest":

> "Such changes are necessary or appropriate for the protection of persons producing, handling, processing or consuming any commodity traded for future delivery on such contract market, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded for future delivery on such contract market." Section 8a(7)

The Commission's mandate to protect the public interest also arises from Section 15 of the Act, wherein it is stated:

> "The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anti-competitive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or...approving any bylaw, rule or regulation of a contract market.."

The least "anti-competitive means" to achieve the concerns of the CBOT and the taker of oil deliveries is to increase the automatic adjustment to a maximum of 20 cents per hundred weight. This change would allow the CBOT to continue to treat all 40 delivery locations equally, in what SDSP would describe as the carrot and stick approach to estimating the cash value of soybean oil in each territory for the last nine years.

SDSP believes a pragmatic review of the data will show:

1. The Soyoil Task Force brushed aside the study by the CBOT Market & Product Development staff. (See Appendix B)
2. The CBOT, in their filing with the CFTC, did not provide adequate data to the C.F.T.C.
3. The CBOT failed to provide an analysis of the long term effects of its proposed amendments. The CBOT is relying on blind faith that its proposed changes will improve the performance of the soybean oil future contract.
4. The CBOT's assumption that a warehouseman who is not located on a Class I railroad incurs higher freight costs and therefore needs a mechanism for a second differential is a flawed conclusion.

Letter to Ms. Jean A. Webb
February 24, 1999
Page Three

5. The CBOT's assumption that all warehouse locations located on a Class I railroad in a given territory have the same economics in a soybean oil cash market is also a flawed conclusion.
6. The performance of the delivery system and the automatic adjustment system of the soybean oil contract has, and continues, to work in a predictable fashion. The Northwest Territory is following similar patterns of other territories in the past.
7. The delivery differentials, adjusted by the cumulative average ratio each year, routinely mis-values soyoil between delivery territories.
8. The delivery differentials with its automatic adjustment system is slow to respond to changing market conditions.
9. SDSP is concerned with the inadequate data submitted by the CBOT to the C.F.T.C on the expected impact of CBOT's regular capacity by increasing rail load-out rates.

The CBOT, in its filing, chose to provide the C.F.T.C. with data spanning only a 2¼ year period. This limited data is inadequate. In the full nine year study of data conducted by the CBOT Market and Product Development staff (See Appendix B), the CBOT's own staff concluded:

1. "Based upon volume and open-interest the soybean oil contract has been very successful and is continuing to be successful."
2. "The automatic adjustment feature should not affect the total number of receipts issued by all the territories but should affect the distribution of outstanding receipts by territories. The data suggests that the automatic adjustment feature is accomplishing its objective ..."
3. "In summary, a review of the above data does not show a problem with soybean oil deliveries or the contract itself."

Relying on selected data and ignoring the findings of its own staff, the CBOT's submittal to the Commission attempts to demonstrate that the Northwest Territory (SDSP) dominates other territories when comparing average outstanding receipts and maximum outstanding receipts. The Commission should also note that this selective data highlights the percent maximum receipts of 93.3% in the Northwest, while the next closest territory has only reached 40%.

Utilizing the entire CBOT Staff study, which includes nine full years of data, The Commission can see a more realistic picture. The Eastern and Illinois Territories lead the average outstanding receipts and maximum outstanding receipts figures. All territories have dominated the percent maximum receipts at some time over the last nine years. Eastern, Eastern Iowa and the Southwest Territories have all held 100% of outstanding receipts while Illinois hit 95.4%. The Northwest recently moved up to 93.3%, and as of February 14, 1999 the Northwest Territory dropped down to 82.7% percent of the outstanding receipts. (Table 1)

The warehousemen located in the Northwest Territory are well positioned to the users (soybean oil refineries) of crude soybean oil. The Northwest Territory has five soybean oil refineries within its boundaries. Two refineries in Des Moines, Iowa are located just outside the Northwest Territory's eastern boundary.

SDSP's primary markets (based on location) include three soyoil refineries. Two are in Mankato, Minnesota, which is 159 miles east of SDSP and the other in Sioux City, Iowa. Mankato is SDSP's primary market due to favorable freight rates along with demand variables. The Mankato market needs 2 to 3 times SDSP's production to feed its soyoil demand, equaling approximately 4,000 to 6,000 jumbo tank cars. Table 2 illustrates the published rail freight rates and truck rates for moving crude soybean oil to soybean oil refineries. Comments and observations include:

- ➢ SDSP's value delivering into Mankato versus a warehouseman located on a Class I railroad
  - ☑ SDSP is the best value into Mankato versus Dawson, Minnesota, and Sheldon, Emmetsberg and Mason City, Iowa. Competing locations are located on a Class I railroad.
  - ☑ Sheldon, Iowa is a single line haul (UP), yet the buyer of oil chooses the truck freight rate of $0.59 cwt. vs. rail freight rate of $0.46 cwt. due to poor service and rail tank car utilization.
  - ☑ Emmetsberg, Iowa is also a single line haul only 110 miles from Mankato vs. SDSP's 159 mile two rail line haul. SDSP has a rail freight rate advantage of $0.25 cwt.
- ➢ Northwest Territory warehousemen to refinery locations
  - ☑ Each delivery point has a different freight rate to a user of soybean oil without regard to the Class of railroad that serves that delivery point.
  - ☑ There is no justification to single out Volga, SD with a special differential (pay freight) due to service by a Class II railroad or otherwise.
- ➢ Southwest Territory warehousemen to refinery locations
  - ☑ Mexico, Missouri has a substantial advantage over Emporia, Kansas. Both are served by a Class I railroad.
  - ☑ Mexico's best freight rate is by rail; $0.25 to North Kansas City
  - ☑ Emporia's rail freight rate into North Kansas City is $0.60
  - ☑ Emporia's best freight rate is by truck to Wichita ,Kansas; $0.40 cwt.
- ➢ East Iowa Territory warehousemen to refinery locations
  - ☑ Shipments into Des Moines, Iowa show Iowa Falls pays $0.35 cwt. (truck), Cedar Rapids $0.43 cwt.(rail) and Mason City $0.56 cwt. (truck).

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The only appropriate conclusion to draw from a review of freight rates from warehouse to the taker (refineries) of soybean oil is that freight rates are not equal in any given territory. It is anti-competitive and unjustified to apply economics to one location in a territory while accepting the automatic adjustment system as an approximation to cash values for all other locations.

The automatic delivery differential adjustment system, while it has its drawbacks, has done a reasonable job in estimating the relative cash values in the different territories. Crude soybean oil is domestically consumed; therefore, product flow is not unidirectional from CBOT's approved delivery points. Applying economics in the form of freight rate differentials for 40 delivery locations would be difficult. Adjusting 40 site-specific delivery differentials to reflect non-transparent cash oil markets, changing market conditions and evolving transportation systems would be next to impossible. A historical review of delivery patterns confirms that the current automatic adjustment system is slow to respond the changing market conditions. In Tables 3 through 11, SDSP has summarized delivery activity by territory by marketing year. Comments on the automatic differential adjustment system includes:

- Eastern and Illinois Territories dominated the delivery activity for the first four to five years.
- The original differentials set for 1990 indicate a mis-valuation. (Table 3) Illinois gained almost 2000 receipts while other territories dropped, which would indicate over valuation of the Illinois Territory against other territories. Automatic adjustment for 1991 (Table 4) shows no change against East Iowa, Southwest and the Northwest Territories. Eastern dropped 10 points.
- 1995/1996 Marketing Year (Table 9): Delivery differentials were Illinois par; Eastern (15); East Iowa (5); Southwest (5); and Northwest (15). Northwest was the only territory not to add receipts during the market year, actually at zero. An indication that at this point of time, delivery of soybean oil in the Northwest was not over valued.
- Two years later in 1997/'98 (Table 11), the Northwest delivery differential was dropped twice for a total of 10 points. Northwest Territory gained in receipts slightly while all other territories show a reduction in outstanding receipts (an indication of over valuation of the Northwest Territory at this time).

Also in reviewing the data (Table 12), once a territory has accumulated a large amount of outstanding warehouse receipts, considerable time elapses drawing the outstanding receipts down to zero (or the lowest level). Ranking of territories by days, peak to low:

Eastern	1,688 days
Illinois	1,261 days
Southwest	684 days
Eastern Iowa	589 days
Northwest	337 days from its peak receipts of 3,696 (as of February 19, 1999)

The data suggests that the automatic adjustment system has been slow to respond in the past and that some territories may have been misvalued for long periods of time. SDSP concludes that CBOT's proposed amendment to double the automatic adjustment delivery differential should address the concerns of the taker of the soybean oil contracts and make the system more responsive to changing market conditions. Likewise, results in the 1993 differential adjustment may be experienced more frequently (Charts 4 & 5). With a 5 point adjustment between Illinois and Eastern Territories, location of receipts flipped between the two territories following the delivery differential adjustment. SDSP does not view this as a concern to the soybean oil futures contract.

Table 14 provides a summary of the relative valuation of soybean oil deliveries by territories over the same nine year period studied by the CBOT staff. First, relative valuations of territories were evaluated by the automatic adjustment to territory delivery differentials. A positive adjustment would indicate that the territory would have been undervalued a year earlier relative to Illinois. A negative adjustment, or an over valuation, had occurred the prior year relative to Illinois. By calculating the net change between territories, one can make a similar observation of relative delivery valuation. For example, 1992 delivery differentials indicate:

- Eastern & Illinois were fair value to each other; differential no change
- Eastern & Illinois was over valued to East Iowa, Southwest & Northwest; differential plus 10 points
- East Iowa, Southwest & Northwest fair value to each other; net differential no change

SDSP's second method in observing relative delivery valuations was done by reviewing the summaries of outstanding receipts by territory in each marketing year. (Tables 3 - 11). SDSP concludes under both evaluation methods that the CBOT has allowed over valuations of the Illinois and Eastern Territories for several years. Having other territories lead in outstanding receipts is something new to the CBOT and the gigantic agribusiness conglomerates that dominate the issuance of soyoil receipts in the Illinois Territory and Eastern Territory (Table 13). However, SDSP cannot condone the CBOT's anti-competitive action with regard to freight rates against a small player such as SDSP.

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The CBOT estimated a 12% reduction of total receipt capacity due to the proposed amendment in load-out terms. The CBOT provided Attachment 7 (Table 15) with a detailed analysis of all existing warehousemen. The CBOT projected SDSP at Volga to drop to 1,372 maximum certificates allowed (a 41% reduction). A closer review of CBOT's Attachment 7 is troublesome to SDSP. Excerpts from CBOT's Attachment 7:

Facility	Maximum Certificates (Cur)	8 Hour Load Out	Maximum Certificates (30 days)
Danville, IL	2,400	18	2,400
Decatur, IL	3,000	15	2,287
Volga, SD	2,300	18	1,372

On behalf of SDSP's 2,100 farm family members, I would like to thank you for your review and consideration. This is a very important decision for the members of SDSP who live in South Dakota, North Dakota and Minnesota communities.

Sincerely,
SOUTH DAKOTA SOYBEAN PROCESSORS

Rodney G. Christianson
Chief Executive Officer

RGC:pc

Enclosures: Tables, Charts, Appendices

Statement of Dayton J. Watkins
Administrator
Rural Business-Cooperative Service
U.S. Department of Agriculture
Before the House Committee on Small Business
September 29, 1999

Good morning, Mr. Chairman, and Members of the Committee, I am pleased to be here to present to the Committee information relative to some of the programs and technical assistance the Rural Development Mission Area provides to assist agricultural producers pursue the development of value-added enterprises as a means of increasing their share of the income generated in the agriculture marketing chain.

The Rural Development Mission Area views producer-owned value-added enterprises as a means of assisting the individual producer increase profitability of their operations; we also view them as critical to the stability of the economies of many rural areas.

Value-added enterprises create new employment opportunities in which most of the income generated from these investments tends to stay in rural areas and supports other businesses.

I should also point out that it is not only the Rural Development Mission Area in USDA that provides assistance to producers as they enter into value-added enterprises. A number of agencies have contributed significant time and resources to specific projects, and success of these enterprises is dependent on this cooperation.

The Alternative Agricultural Research and Commercialization Corporation, the Natural Resources Conservation Service, the Farm Service Agency, the Agricultural Marketing Service, and the Research and Extension components of USDA have all been involved in a number of projects to assist producers in these endeavors.

A most recent example that involves a variety of sources of technical assistance and very little financial assistance is the New North Florida Cooperative through which a small number of limited resource farmers are increasing their profitability by supplying fresh vegetables and fruits to local school districts.

This cooperative evolved through the efforts of many parties, including the Natural Resources Conservation Service, the Agricultural Marketing Service and Florida A&M University. The Rural Business-Cooperative Service provided some assistance in helping the cooperative organize and a local bank provided the financing for a processing and packaging facility.

The Rural Business-Cooperative Service has a variety of programs that we are using to finance value-added enterprises.

But, the flagship program that we use is the Business and Industry Loan Guarantee program, through which we can guarantee loans to cooperatives to finance value-added facilities, and to individual producers to purchase stock in new cooperatives. The latter authority was provided in the 1996 Farm Bill.

For the past few years, the Business and Industry loan guarantee program has been funded at $1 billion and, to stimulate agriculturally related value-added projects, we have established a policy goal of using $200 million for the types of projects being discussed here today. For example, this year we guaranteed a $25 million loan to a producer-owned sugar beet processing plant in eastern Washington.

We have also just made a commitment to guarantee a loan to a small swine processing plant in Minnesota, and in conjunction with that we also guaranteed loans to individual producers to purchase stock in the cooperative.

We are also using this program to participate in projects financed, in part, by the Alternative Agricultural Research and Commercialization Corporation. One such project is a soybean processing plant in Michigan.

Other financing programs available from the Rural Development Mission Area include the Rural Business Enterprise Grant program through which we are able to assist small and emerging businesses with facilities, feasibility and marketing studies; and the Rural Economic Development loan and grant program which is available to rural electric and telephone borrowers to finance a wide range of projects.

The Rural Business-Cooperative Service also provides technical and research assistance to existing and new cooperatives. The Cooperative Development grant program provides technical assistance to cooperatives through a network of Cooperative Centers that provides hands-on assistance in a number of areas, including helping with the start-up of new cooperatives.

These Centers have been instrumental in the establishment of a number of new ventures. Examples include a pasta plant in North Dakota, and a bakery in Colorado, both of which utilize the wheat produced by their member-producers; and a sweet potato processing plant in Alabama which the raw commodities are grown by member-owners.

In addition, the Cooperative Services here in Washington provides assistance to new and existing cooperatives upon request. Additionally, some of our State Offices have full time cooperative specialists, while other offices have a cooperative specialist with collateral responsibilities. These specialists assist cooperatives in organization, management, financial matters, marketing, and research.

Mr. Chairman, while we are enthused about the successes we have had in assisting producers strengthen their position in the food chain, like any new business, there are as many opportunities for failure as there are for success.

And, as with other small business ventures, the primary factors leading to failure are insufficient and inadequate capital marketing and management skills.

Most producers, particularly smaller producers who also work off farm to make ends meet, all to frequently do not have the time to devote to marketing and management of another enterprise. They must depend on those that have those skills. And, all too frequently they do not have the capital to invest in a new venture, particularly when commodity prices are low.

Unfortunately, the producer interest in cooperatives and value-added enterprises increases when commodity prices are low and wanes when prices begin to rise.

Mr. Chairman, this completes my formal statement, I would be happy to entertain any questions the Committee might have.

TESTIMONY OF

THE AMERICAN BANKERS ASSOCIATION

Presented to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

October 7, 1999

Introduction

Positioning Agriculture and Rural America for the 21st Century

In January 1999, the American Bankers Association (ABA) formed a 10-member national Task Force on 21st Century Agricultural Banking. This Task Force was conceived out of a need to rapidly respond to recent volatility in agricultural economic conditions, as well as the need for a longer-term response to address structural changes of the food system and rural America. The Task Force reviewed various reports, the works of previous ABA task forces, current briefing materials, and discussed various recommendations over the course of six months.

Since 1911, the ABA and its member institutions have taken a leadership role in responding to developments and concerns in agriculture and rural America. This report continues ABA's tradition of excellence in serving rural America. In establishing this Task Force, the ABA has drawn upon a broad cross-section of ABA agricultural banking leaders that represent the network of approximately 20,000 banks and branch offices located in rural communities and major agricultural production areas from across the nation.

Three audiences with a vital interest in the work of the Task Force were identified: bankers, policymakers, and customers in agriculture and rural America. Bankers will be in better position to respond to the developing concerns in agriculture and rural America, if they are a part of the dialogue and search for solutions to changes in the rural economy. Policymakers, who are searching for more effective solutions, will be better able to respond if they know and understand conditions in the financial services industry, best practices and banker recommendations for action. Finally, agricultural producers, rural customers, and rural leaders look to their hometown bankers for leadership, ideas, and suggestions; so they can survive, thrive, and position rural America for the 21st Century. Citizens in rural America want to know that their bankers are searching for solutions to emerging trends and the banking industry will help to position rural America for the next millennium.

The Task Force identified the following fundamental strategies for responding to the emerging trends and structural changes in agriculture and rural America:

- Create a Framework for Farmers & Bankers to Manage Agricultural Risks.
- Create New Avenues for Local Bank Access to National Capital Markets.
- Create Tools for New Ventures & Opportunities in Rural America.

In addition to the policy recommendations, the Task Force placed high priority on creating a Center for Agricultural and Rural Banking. The Task Force believes a Center should be established to provide national leadership and visibility for ABA initiatives and responses to short- and long-term concerns in agricultural and rural banking. The Task Force envisions that much of the leadership for implementing the following policy recommendations should be encompassed in the Center's work. Since the Center proposal represents a recommendation that is internal to the ABA organization, it has been developed as a separate proposal to the ABA Board. Coupled with the policy recommendations, the Center may well be one of the more important deliverables recommended by the Task Force on 21st Century Agricultural Banking.

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I. Create a Framework for Farmers and Bankers to Manage Agricultural Risks.

The Task Force identified three major principles to be used in designing a framework for farmers and their bankers to manage agricultural risks. A world-class risk management system would:

- Promote self-help solutions
- Allow individuals to determine their own destiny with minimal government intervention
- Utilize public-private partnerships rather than bureaucratic top-down approaches to program design and implementation

Consistent with these principles, the Task Force strongly supports the following priorities:

A. FSA Guaranteed Loan Funding is a Top Priority.

The USDA, Farm Service Agency (FSA) Guaranteed Loan Programs represent a model public/private partnership that has worked for agriculture. During the 1980s, the federal government believed the way to respond to the credit problems of farmers and ranchers was through a massive direct loan program. At one time, USDA had nearly $28 billion in direct loans to farmers and ranchers. The problems USDA had with the direct loan program in the 1980s need not be reviewed. It suffices to summarize that these problems contributed to a rethinking of the role of government. The government's primary delivery strategy was changed to foster working with the banking industry – instead of competing with it.

Since the 1980s, FSA's Guaranteed Loan Program has been a public-private partnership success story. Some 48,000 farmers and ranchers have 65,000 loans from banks and other private sector lenders that are guaranteed by the Farm Service Agency (FSA). Each year FSA receives approximately 15,000 requests for new guaranteed loans. Today, the guaranteed loan portfolio has about $6.8 billion outstanding and currently only about 2.4% of the payments are past due. In other words, the banking industry's non-guaranteed loan portfolio to farmers and ranchers currently has a past due rate of 1%. Considering the fact that FSA guaranteed loans are made only to those farmers and ranchers that have some type of credit weakness, this portfolio of guaranteed loans is performing very well.

More than 80% of all Farm Service Agency guaranteed loans are written by banks. The Task Force believes the Guaranteed Loan Program is an essential tool to help farmers and ranchers get the credit they need. Agricultural bankers are very judicious in the use of the programs, and the regulations require each lender to certify on every application submitted to USDA that credit cannot be provided at comparable rates and terms without the guarantee. Lenders typically service guaranteed loans more closely than other loans. USDA regulations require close monitoring of the borrower's performance, maintaining close tabs on the collateral and constant monitoring of the customer's financial condition. Further, if the situation requires a lender to liquidate the account, USDA requires that all collateral and sales proceeds be accounted for before the lender may apply for a loss payment. FSA has adequate safeguards to make sure poor underwriting and loan servicing practices are not tolerated. Lenders that fail to meet these strict conditions lose money. This process assures a true three-way partnership among the farmer, the banker, and the FSA.

1. Immediate and continuing action to create an adequate supply of nationwide funding for FSA Loan Guarantee Programs.

As rural leaders contemplate how the federal government should respond to the needs of the agricultural sector during challenging times now and in the future, the Guaranteed Loan Programs offered by the USDA should be regarded as be one of the most cost-effective, high impact tools that Congress can provide. This program is not an answer to low agricultural prices, but it is an effective short-term response targeted directly to financial stresses faced by farmers and ranchers. Benefits of the program do not go to farmers who are not financially stressed or those who are beyond help. The program's scarce resources are targeted only to those farmers with cash flow problems for which the assistance can make a critical difference between financial survival and failure.

In FY 1999, USDA experienced unprecedented demand for FSA guaranteed loan funds. For the first time in the history of the program, funding for all FSA guarantees was exhausted well before the end of the fiscal year. In May 1999 Congress approved additional supplemental funding, but that funding was quickly exhausted as well. Demand for guaranteed loans was high in 1999 due to the worsening economic conditions in agriculture and banks trying to do everything they could to restructure their customer's loans to accommodate reduced cash flows.

In the short run, increased flexibility for internal reallocation of USDA funding can alleviate some timing and funding gaps for agriculture, temporarily. However, it is critical that a greater commitment be made by Washington to assure farmers that adequate funding is available in a timely manner. Demand for guaranteed loan funds will likely grow dramatically if commodity prices do not improve. The shortfall in funding for FSA Guaranteed Loan Programs is seen as a critical problem that demands the attention of the Congress and the administration. If the guaranteed loan programs offered by USDA are not adequately funded, it will be increasingly difficult for banks to meet the credit needs of all of their farm and ranch borrowers.

2. FSA should continue to streamline programs and provide regulatory flexibility.

The Farm Service Agency has recently reformed the FSA Guaranteed Loan Programs along the lines that ABA has advocated for a number of years. The Task Force hopes that the new regulations for the Preferred Lenders Program, low documentation loan application for small loans, and many other program improvements will result in an FSA program that will more efficiently deliver greater access to capital for a wider range of agricultural borrowers. If the agricultural economy continues to erode, more and more farmers and ranchers will need the type of assistance provided by the FSA Guaranteed Loan Programs.

Due to developments in the agricultural economy, the Task Force recommends several immediate actions to increase the flexibility for the FSA Guaranteed Loan Program. The Task Force recommends that FSA abandon the 110% cash flow coverage requirement. This recommendation is particularly important as more farmers experience cash flow problems. A cash flow coverage of 100% should be sufficient for FSA, especially if the bank is willing to make the loan.

FSA's current system of program delivery continues to reflect an earlier time when resources were more plentiful. Over the last 40 years, predecessor agencies (FmHA and ASCS) deployed vast delivery networks that were highly local and heavily dependent on skilled labor. The people who built this delivery system are to be commended for their contributions to the health and well being of rural America. But times continue to change for rural America, and FSA must reinvent itself to meet the future challenges of rural America. FSA should consolidate guaranteed loan making and loan servicing at state offices, or in specialized districts in very large states to ensure consistency and efficiency of program delivery.

For example, loan officers for one bank in South Dakota deal with nine different FSA County Offices. Due to complex set of procedures that must be followed when administering the guaranteed loan program, there are inevitable inconsistencies among the nine offices. Further, it no longer makes economic sense to try to maintain a delivery network that worked best before there was fax or e-mail communication. The banking industry has the local infrastructure necessary to deliver credit. FSA's role is to provide the necessary oversight for the private sector lenders and this can be done much more efficiently.

3. Immediate action to remove the 15-year FSA borrower eligibility limit.

Congress should revisit the term limits on guaranteed loan eligibility. While bankers have moved many farm borrowers from direct FSA loans to guaranteed bank credit, and then to non guaranteed bank credit, there are some borrowers who–for a variety of reasons–must continue to have their credit guaranteed by FSA in order for the private sector to lend to them. Agricultural bankers in some areas are starting to encounter more and more borrowers who are running out of eligibility. In addition, this requirement has created severe administrative challenges for the FSA. Given the fact that the agriculture sector is expected to be under increased financial stress, the current term limits should be eliminated.

4. Organize an annual stakeholders meeting with USDA.

The purpose of an annual stakeholders meeting would be to provide an opportunity for two-way communication between USDA agencies providing rural credit enhancement programs and bankers serving agriculture and rural America. The agenda for a stakeholders meeting might include a review the performance of USDA credit enhancement programs, progress made in streamlining implementation of the programs, and discussion of next steps in the ongoing process.

B. Crop Insurance Reforms.

The Task Force supports a stable and reliable federal crop insurance program with private sector delivery. America's bankers and their customers know that dependable crop insurance can, and frequently does mean that bankers are able to approve operating loans and other types of credit for farmers struggling to stay ahead in higher risk situations, volatile weather, and challenging agricultural markets. Insurance can help producers recover their input costs when crops are damaged by unexpected circumstances, protecting them from financial disaster.

The Task Force examined numerous aspects of the current crop insurance programs and discussed various improvements for the future. While crop insurance has worked for farmers that buy it, the Task Force believes more needs to be done to make these programs more effective for all of America's farmers and ranchers.

1. Stronger links between crop insurance and income protection are needed.

Efforts to link crop insurance protection with price protection have been marginally successful. According to USDA, only about 16% of corn and soybean producers, who have bought the higher levels of crop insurance coverage, take revenue insurance. New innovations such as whole farm revenue or cost of production insurance may prove to be more efficient than insuring each enterprise separately on the same farm. In addition, livestock producers face similar challenges with access to feed and forage during adverse weather conditions. More can be done to develop, test, and remove barriers for implementing innovative concepts that hold promise for addressing the risk management needs of the nation's farmers and ranchers.

2. Actuarial soundness is not working in the present system.

While it does not make sense for government to try to indemnify farmers from all crop related problems, a world class agricultural insurance system should provide affordable coverages so that most farmers are covered for all significant crop losses and major disasters. The need for additional disaster assistance continues to be necessary, in part, because of the inadequacy of the present crop insurance system. Farmers in high-risk areas should have access to more affordable crop insurance for covering all significant production shortfalls without the persistent periodic need for disaster assistance on an ad hoc basis. Farmers in lower risk production areas should benefit from even lower premiums. Otherwise, regional distortions in planting and industry investment decisions will occur.

The Task Force believes that even if the concept of actuarial soundness were redesigned in a way that increased the cost of the program, it would still be less costly than if Congress continues to intervene with ad hoc disaster payments.

3. Yield coverages and price elections are not adequate and are inflexible.

Many producers are working on very thin profit margins. Crop insurance, at the higher levels of coverage, is disproportionately more expensive because as the producer buys up, the federal subsidy declines. The highest subsidy should be on the highest level of coverage rather than the lowest level of coverage. While USDA should be commended for earmarking $400 million in FY1999 to provide producers with added incentive to buy crop insurance, producer participation will likely decline if this one time incentive disappears and/or if major reforms do not occur.

Catastrophic Coverage (CAT) and Non-Insured Assistance Program (NAP) has been universally rejected by farmers. CAT is a "floor" level of insurance that producers buy and NAP is a program intended to protect producers that grow non-insured crops. The Federal Crop Insurance Corporation (FCIC) acknowledges that CAT and NAP coverage is not sufficient to provide farmers with adequate coverage, and only two thirds of the farmers that have CAT coverage purchase buy-up coverage. Livestock producers face similar problems with access to feed and forage coverage during adverse weather conditions.

Insurance coverage is based on an individual farmer's Actual Production History (APH). If a farmer has had a string of bad years, his APH will be reduced, thus reducing the level of insurance coverage that he can buy in the future. Many farmers have had their APH reduced to the point that it is no longer economically feasible for them to buy the insurance. Farmers that have experienced multiple year crop disasters are hit with a double disincentive: lowered yield coverage and higher premium rates.

The current system of buying insurance based on a market price established months before crops are actually harvested creates a situation that drives farmers away from the program. Farmers typically do not want to insure all of their output at prices in the spring, which may be below their cost of production. Therefore, price elections need to provide a floor with upside potential if the market moves up.

C. Create Incentives to Save for Bad Times.

While crop insurance represents one cornerstone for creating a world-class agricultural risk management system, Congress should not overlook incentives to encourage farmers and ranchers to save for bad times. Government incentives for a savings program might take on several forms: matching contributions, interest rate bonuses, tax credits or deferred income tax incentives. The Task Force supports the concept of income stabilization savings accounts and believes there are several benefits of such a program.

1. Incentives for savings are self-help investments in farm income stability.

Farmer contributions to income stabilization savings accounts represent an investment–not an operating expense. The accumulation of annual contributions and compounded interest adds to asset growth on the farmer's balance sheet and represents a diversification in sources of income to further reduce net income risk for the farmer. The availability of self-help savings accounts allows the government to annualize a portion of ad hoc disaster program costs into farm income stabilization incentives over time–reducing unexpected government disaster program costs and enhancing the predictability of agricultural risk management program spending.

2. Deposits in Federally Insured Depository Institutions create economic vitality.

Contributions to a farm income stabilization savings account should be deposited in Federally Insured Depository Institutions to assure that farmer and government contributions are maintained in a secure manner. Self-help savings accounts have the potential to increase deposits that would then increase the lending capacity of many rural banks. This in turn represents increased potential for economic development in rural communities.

D. Greater Conservation Reserve Program Participation.

In general, the nation's farmers have appreciated the increased planting flexibility afforded by the 1996 farm bill. However, the increased prospects for agricultural exports have not played out due to unforeseen troubles in the Asian economy and other factors. As a result, good weather and large crops have the potential to provide excess capacity and overproduction. The Conservation Reserve Program (CRP) represents a *de facto* acreage reduction program that could ease the pressure of excess capacity on agricultural prices. The 1996 farm bill continued authority for CRP at 35 million acres. At the same time, the criteria for accepting acreage into the CRP shifted the focus from soil conservation to enhancing water quality. The currently enrolled acreage stands at about 31 million acres. In recent months, some agricultural leaders have called for increasing the CRP acreage authorization up to 40 million acres. The Task Force believes that increased authorization and funding for more CRP participation may be a cost-effective approach to addressing the potential for longer- term agricultural surpluses in an environmentally sound manner.

II. Create New Avenues for Local Bank Access to National Capital Markets.

The Task Force on 21st Century Agricultural Banking builds on the work of a previous ABA banker group that was focused on rural economic development. Like them, the Task Force believes there is growing evidence that several gaps exist in rural capital markets. After reviewing several options for supporting economically sound agricultural and rural development projects, the Task Force concluded that Congress must place a higher priority on closing rural capital market deficiencies.

Historically, the federal role in closing capital market gaps has been implemented through direct assistance and Government-Sponsored Enterprises (GSEs) with access to the "agency market." GSEs include the Federal Home Loan Bank (FHLB) system, Farm Credit System (FCS), Fannie Mae, Freddie Mac, and Farmer Mac. The Task Force believes the public mandate and the appropriate role for GSEs are to work with and assist private sector institutions in closing the identified gaps in capital markets–not to compete with private sector institutions in retail markets. Unfair competition, inefficient resource use, and duplication of effort often result when GSEs compete directly with private sector institutions. The Task Force identified the following priorities for creating greater bank access and re-deploying GSEs to close gaps in rural capital markets.

A. Expand FHLB Authority, Expertise, and Flexibility.

The Task Force concluded that expanding Federal Home Loan Bank (FHLB) authority and linkage with banking networks in rural communities would help fill gaps in rural financial markets. The FHLB system has historically focused on underwriting home loans in urban markets. Expanding FHLB authority and linkage with banking networks would improve access to credit for business, housing and infrastructure for rural areas. Access to agency markets has been severely limited for many banks that operate in rural markets. The FHLB provides an efficient means of bringing lendable funds to rural America through commercial banks because the FHLB is able to sell debt in the agency market. The Farm Credit System (FCS) also sells debt in the agency market, but unlike all of the other GSEs, the FCS is a direct retail lender.

Expansion of FHLB authority would provide one step toward creating a level playing field in serving the broader capital needs of rural America.

1. Immediate action to expand FHLB authority.

As the deposit base erodes for many banks in rural communities, a number of viable rural development opportunities may be forgone due to barriers in accessing funding. Expanded access to the FHLB represents an additional source of liquidity for banks in rural communities to meet the credit needs of their local economies.

Banks play a key leadership role in rural economic development by being active in business, industrial, and infrastructure lending. Expanded FHLB access would permit banks in rural areas to match the maturity of the funding source with that of a rural development project, reducing interest rate risk to the borrower and the lending institution. Many banks are also familiar with FHLB loan procedures because they have used the system to support home loans and other limited loan activity. Linking the FHLBs and rural banks would be a good match that would enhance access to capital for rural America.

2. Immediate action to maximize the value of rural collateral.

Currently, the Federal Home Loan Bank System is revising its underwriting standards to better serve its emerging majority of bank members. FHLB expertise and historical underwriting standards have been designed for housing markets situated in urban areas. To successfully serve the unique needs of rural America several changes to FHLB service are required.

First, educational efforts to further develop rural capital market expertise are needed within the FHLB system. Banks from rural communities that are addressing a gap in the local capital markets should be able to utilize collateral beyond the FHLB's previous standards designed more for urban markets. In addition, the FHLB system needs to develop expertise in agriculture, rural business, and infrastructure financing.

Second, the FHLB system needs underwriting standards more appropriate for rural community development. If this is accomplished, banks using the FHLB could more readily serve loan requests typical of rural development infrastructure, technology-based businesses, and value-added agricultural projects.

Finally, expanded FHLB authority should not be limited to small business loans. Banks that serve rural community capital markets typically serve all market segments in the community.

B. Two Visions for the Future of the Farm Credit System.

The Task Force concluded that the Farm Credit System (FCS) has clearly been afforded substantial subsidies. It has been estimated that the FCS's corporate income tax subsidy in 1997 was approximately $350 million or 75 basis points per dollar of funds loaned. When additional tax advantages granted at the state and local levels are added along with the implicit subsidies received by FCS access to the "agency market," the total subsidy delivered to the Farm Credit System equals $600 to $800 million per year. This amounts to a pricing advantage of 150 basis points (or 1.5% APR) on the average FCS loan for agricultural purposes.

Recent changes in FCS lending practices suggest the FCS has targeted larger, well-established farm families that are in a strong financial position. Thus, government subsidies are going to larger, established farm families in strong financial position. Low income, small, beginning, and young farmers are less likely to receive FCS financing and therefore do not receive the benefit of the federal subsidy.

In 1999 the Farm Credit Administration (the regulator of the Farm Credit System) proposed a controversial new rule that will result in rapid consolidation within the Farm Credit System and abandonment of their original public purpose. The proposed rule, titled Customer Choice by the FCA, would allow FCS institutions to make loans outside of their designated territories. Serious public policy issues have been raised by the proposed rule. The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for segments of a government sponsored enterprise to compete with itself and other private sector institutions. The FCA does not appear to be exerting their regulatory responsibilities. Instead, the FCA seems to be working to undermine the safety and soundness of the Farm Credit System. Left unchecked, the Farm Credit System may revisit the financial problems they encountered in the 1980's. The threat of renewed reckless lending by the FCS is a threat not only to the stability of rural America but to the American taxpayer as well.

In the final analysis, the FCS is using its unique tax advantages and GSE agency market advantages to "cherry pick" loans from private sector lenders. The FCS was created by Congress to fulfill capital market gaps for farmers and cooperatives in areas where credit was not available. The Task Force concludes there are two long-term options for the FCS. The first option is for Congress and FCS to refocus their mission to work with rural private sector lenders. The second option is to allow FCS institutions to become privately owned and capitalized institutions and to surrender their GSE status. For those FCS institutions that wish to remain part of the FCS, Congress should review the mission of the FCS in order to make sure that a public policy objective is being met.

1. Option 1: FCS becomes a source of liquidity for all rural lenders.

As outlined in the 1994 ABA Task Force report, *New Tools for Commercial Banks in Rural America*, there is potential for the FCS to enhance its role as a source of liquidity for rural banks in the Farm Credit Act of 1971. Under these provisions, commercial banks and other private sector lenders may form Other Financial Institutions (OFI). An OFI may, under very prescribed circumstances, borrow from Farm Credit Banks to support their lending to farmers, ranchers and producers or harvesters of aquatic products. Unfortunately, the inflexibility of the OFI structure precludes appropriate participation by non-FCS institutions. In 1994 the American Bankers Association recommended a more flexible reconfiguration of the Farm Credit System that would enable the FCS to provide wholesale funding to commercial banks for rural lending purposes.

Unfortunately, the FCS rejected this concept. The Task Force believes that this concept should be reexamined. If the FCS wishes to maintain its tax subsidies and agency market access, then it must provide a clearly recognized public benefit. Reconfigured to provide rural lenders with access to lendable funds, the government subsidies afforded to the FCS would be distributed more evenly to all farm borrowers, not just those currently targeted by FCS retail lenders.

2. Option 2: Allow the FCS to privatize.

If the FCS wishes to compete at all levels in the rural retail credit markets with private lenders, then its access to unfair tax subsidies and agency market status should be abolished. Privatizing would allow the FCS institutions to operate more freely, unencumbered by geographical boundaries and public mandates other than those experienced by other private sector lenders.

C. Place More GSE Emphasis on Closing Rural Capital Market Gaps.

GSEs perform an important role in providing an external source of funds for banks and closing the gaps in local capital markets. GSEs have been instrumental in creating standardized underwriting practices and fostering the creation of secondary markets. However, the benefits of GSEs have been disproportionately experienced in urban areas. To serve the needs of rural America, it is particularly important that GSEs make a greater commitment to rural America where unique gaps exist. In particular, underwriting standards and regulatory complexity should not arbitrarily restrict access for smaller loans and smaller lenders that are unique to rural capital markets.

1. Fannie Mae and Freddie Mac should expand efforts to serve rural housing markets.

Fannie Mae and Freddie Mac have traditionally been less involved in rural housing markets. While these GSEs have recently developed programs targeted to rural and under-served areas, they could play a much larger role. Today, only a small part of both GSE portfolios is based in rural America. Significant effort must be made to get Fannie Mae and Freddie Mac more involved in meeting the credit needs of rural home borrowers.

2. Farmer Mac should continue its important function in agricultural credit delivery.

The Federal Agricultural Mortgage Corporation (Farmer Mac) has a presence in rural communities through its participation in the secondary market for farm real estate mortgages and rural housing. Farmer Mac's impact is still small in the agricultural mortgage market, but it holds great promise. Through Farmer Mac, banks are able to extend fixed rate, long term real estate mortgages to their customers while passing interest rate risk to secondary market investors. The Task Force believes that Farmer Mac should continue its important function in the delivery of agricultural credit.

D. Support Efforts to Increase Availability of Rural Equity Capital.

For startup businesses and expansions, access to equity capital often means the difference between doing a project and not doing a project. Several studies indicate equity capital is less available in rural America compared to metropolitan areas. At the same time, new models of agricultural production (value-added cooperatives, producer alliances, producer networks, and supply chains) require significant amounts of equity capital. In rural areas, where capital gaps exist, bankers can transform enhanced access to equity capital into increased loans, jobs, and vitality for the rural economy. The Task Force recommends the following to improve rural equity capital access.

1. Regulatory flexibility for rural banks to enhance equity capital.

In general, banks have some flexibility to form special purpose entities called Other Financial Institutions (OFIs), such as bank Community Development Corporations (CDCs) or Small Business Investment Corporations (SBICs). However, the ability of smaller rural banks to form these special purpose entities is often severely constrained because of a regulatory limit on bank capital that can be invested in these entities. The current limit is 5% and this limit effectively curtails the ability of rural banks to form bank CDCs and SBICs on a scale that is meaningful. The Task Force recommends that the capital limit for banks in rural and other under-served areas be increased, if they are well capitalized and if there are no supervisory concerns. This will provide greater flexibility to enhance rural equity without jeopardizing the safety and soundness of the bank.

Federal and state incentives for equity capital development should contain some targeting to rural America. Incentives designed to encourage investment may have little impact on equity capital availability in rural areas, unless they are specifically targeted and designed to do so. The Task Force recommends that future federal and state initiatives for encouraging equity capital should give some special targeting consideration to assure that rural America is not bypassed.

2. Banks are critical to the successful development of rural equity capital networks and entrepreneurs.

Banks serving agriculture and rural areas have long provided critical assistance in mentoring rural entrepreneurs. Rural business development centers and entrepreneur mentoring programs increasingly play a critical role in providing technology and technical assistance. As new initiatives are developed in the public sector, it is critically important that banks be involved to enhance opportunities for success.

For example, the USDA has maintained authority since 1996 to provide loan guarantees for eligible farmers who borrow funds from private lenders to capitalize new value-added cooperatives. This Cooperative Stock Purchase Program (CSPP) has been underutilized for two reasons. First, few bankers and farmers are aware of the program. Second, eligibility requirements and regulations have made the program impractical for most new fledgling cooperatives. The Task Force believes that this is just one example of how more could be done to enhance the public private partnership if the private sector was better integrated into the development and deployment of public initiatives.

E. Greater Flexibility for Banks to Use Innovative Forms of Business Organization.

Various innovative forms of business organization, such as Subchapter S corporations and Limited Liability Companies, are available to a wide range of businesses. In order to create greater opportunities to raise capital, banks should be provided greater flexibility and choice concerning organizational structure. Providing greater flexibility for banks serving rural America would stimulate more rural economic vitality.

III. Create Tools for New Ventures & Opportunities in Rural America.

Nationally, rural community populations possess a higher percentage of senior citizens. In many rural communities, those who are over age 55 increasingly hold businesses, farms and ranches. As a result, it is increasingly common for the control of capital to be transferred out of a rural community to estate heirs who live in metropolitan areas. As the number of families, relatives, and friends with control over accumulated wealth decline in rural America, potential capital gaps widen. The long-term impacts include reduced opportunity for creating new farming operations, new business ventures, and reduced ability to retain local entrepreneurs.

The Task Force identified two critical areas for strengthening and positioning rural America for the emerging challenges of the global economy (1) creation of new and updated tools for young and beginning farmers and (2) creation of more effective tools for new ventures and new opportunities in rural America. The specific recommendations include the following:

A. Aggie Bonds for Young Farmers and Rural Entrepreneurs.

Fifteen states currently administer state industrial revenue bonds for agricultural borrowers. They are commonly referred to as "aggie bonds". Aggie bonds represent a cost-effective method of providing reduced interest rate loans to young and beginning farmers for capital purchases of farmland and equipment. Local lenders are able to offer below market interest rates to qualified young and beginning farmers because of the federal (and state) tax exemption on these bonds. Typically, a designated state agency issues the bonds and charges a nominal processing fee. Banks using the program are able to provide interest rates to the eligible beginning farmers that are one to three percent lower than commercial farm loan rates. The Task Force has four recommendations regarding aggie bond programs.

1. Educate the banking community about aggie bonds.

Currently, only bankers serving agriculture and rural communities in the 15 states with active aggie bond programs are likely to know very much about the use and value of these programs. As a result, there is a need for ABA to conduct a national training initiative for bankers serving rural capital markets in the other 35 states to learn more about the program.

2. Remove the federal industrial revenue bond cap on aggie bonds.

Unfortunately, aggie bonds are subject to a federal volume cap on industrial revenue bonds (IRBs) and must compete with industrial projects for bond allocation. This results in insufficient volume for aggie bond programs. In many states, aggie bond availability is severely limited and deserving young farmers and ranchers are not able to benefit from these bond programs unless they are at the right place at the right time. Opportunities that may exist for a beginning farmer at one point in time may not exist six months later during the next fiscal year. Arbitrary allocations have real impacts in terms of providing equal opportunity for beginning farmers and impose unequal hardship conditions on otherwise eligible beginning farmers. Timing of finance is often a critical factor in the acquisition of agricultural property.

State officials often favor using the state's IRB volume allocation on higher value industrial projects or housing that shows greater returns in the short run. Because aggie bonds are different from typical IRBs, they are often at a competitive disadvantage for receiving IRB allocations. In contrast to IRBs, aggie bonds cannot exceed $250,000 and the average size is less than $125,000. They are purchased by local lenders and are not rated, underwritten or sold into capital markets. In contrast, typical IRBs are used by corporations, issued in greater than million dollar amounts, are often underwritten, and sold to capital market investors. Within individual states, the IRB volume cap is often allocated to larger manufacturing and multi-family housing projects. Therefore, small beginning young farmers and startup businesses in rural and underserved areas are often left without adequate access to aggie bonds due to the federal IRB volume cap.

3. Allow USDA and SBA guarantees on aggie bonds.

Currently, banks that utilize aggie bonds are not allowed to secure a federal guaranty on the credit. Making aggie bonds eligible for USDA and/or SBA guarantees would sufficiently reduce repayment risk such that the borrower's interest rate could be reduced by a larger increment. Both USDA and SBA maintain that they are prohibited from providing a guarantee on a tax-exempt issuance. However, there is a precedent for this recommendation. Elements of the Farm Credit System are tax exempt, and yet the entire Farm Credit System enjoys access to USDA and SBA guarantees on loans they originate. Therefore, this recommendation represents a step toward creating a more level playing field in rural capital markets.

4. Expand trading of aggie bond authority.

Some states have begun to trade unused bonding authority. If aggie bonds are not exempted from the federal IRB volume cap, the Task Force believes many bankers would be interested in accessing unused authority that might exist in neighboring states.

B. USDA and SBA Loan Guarantee Programs for Young and Beginning Farmers and Rural Community Entrepreneurs.

The development of young and beginning farmers and rural community entrepreneurs is a fundamental necessity to ensure U.S. leadership in the emerging global agricultural markets and food industry of the future. As new trends in technology, market segmentation, specialization, and contractual integration accelerate the coordination and management of agricultural resources and markets will become more entrepreneurial and business oriented. In the past, young and beginning farmers have primarily entered production agriculture under the tutelage of parents, neighbors and relatives. Today an increasing number of beginning farmers are returning to the farm after accumulating capital, gaining experience, acquiring management skills, and being mentored in other farming operations, the food industry, or other segments of the economy.

Because the threshold for entry into agriculture has continued to rise, the Task Force believes that now is the time to evaluate the system for assisting young and beginning farmers and other rural community entrepreneurs. As discussed in Chapter I of this report, the Task Force believes USDA Guaranteed Loan Programs embody the essential tools for helping farmers and ranchers to access the credit needed during rough economic conditions in agriculture. FSA and SBA guaranteed loan programs are critical for helping young and beginning farmers to access the credit needed for entry into agriculture.

C. Expand Use of Linked Deposit Programs.

Several states–such as Texas, Ohio, and Iowa–have developed linked deposit programs specifically for assisting local banks with intergenerational transfer of existing rural businesses. In each case, a local bank accepts an application from a borrower who is eligible for the linked-deposit program. The borrower and bank submit an application to the appropriate state agency. The state agency agrees to deposit funds for a certificate of deposit (CD) in the local bank equal to the amount of the approved loan. The state accepts a below market interest rate on the

CD with interest payable at loan maturity. The Task Force believes that linked deposit programs are an important way that some agricultural and rural borrowers can be assisted in securing the capital they need at an affordable cost.

D. Reshape Education for Young Farmers and Rural Entrepreneurs.

Emerging trends in production agriculture require new and different approaches to education, training, and mentoring. Educational needs are becoming more specific to the enterprise and resources to be managed by the beginning farmer and rural entrepreneur. The Task Force identified the following needs for consideration in reshaping education, training, and mentoring programs.

1. Support programs that leverage information technology.

Today, commercial farmers and business people in the U.S. can access the best information resources anywhere around the globe to assist them in making better management decisions. Young and beginning farmers and rural community entrepreneurs must increasingly have access to the best information available via Internet and distance education to enhance the success of their operations. The Task Force supports efforts to leverage information technology for disseminating the latest in agricultural research, education and information to assure equal access for all producers and rural community entrepreneurs.

2. Create rural SBDCs and networks for young farmers and rural entrepreneurs.

Several industry groups, government agencies and universities are developing specific programs to provide the latest information regarding industry-specific developments for young and beginning farmers. The Task Force believes that banks would welcome the opportunity to partner with agricultural industries, agencies and universities for specific educational workshops that include marketing, farm accounting, financial and risk management. Furthermore, the Task Force welcomes opportunities to dialogue with agribusiness and farm interests, government agencies, universities, and policy makers on the lessons learned from Small Business Development Centers. These lessons may be useful in formulating similar strategies for developing young and beginning farmers.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership–which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks–makes ABA the largest banking trade association in the country.

Task Force on 21st Century Agricultural Banking

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The American Bankers Association (ABA) is pleased to be able to submit this testimony for the record to the House Committee on Small Business hearing to review the situation in agriculture and rural America. We greatly appreciate the opportunity to share our industry's recommendations on the future of rural America with you.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership-- which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks -- makes ABA the largest banking trade association in the country.

Thousands of ABA member banks are very concerned about their farm, ranch and rural customers. Over the last 24 months the agricultural industry has experienced a roller coaster of price highs and lows, and currently we are experiencing historic price lows. Unfortunately, lenders can do nothing to raise the price of corn, wheat, soybeans, hogs or cattle. It is the banking industry that provides the vital credit that farmers and ranchers need to be successful. The banking industry has more at stake in the future of agriculture than any other lender. At the end of 1998 banks had over $70 billion outstanding to farmers and ranchers; more than forty-one cents out of every dollar of credit loaned to every farmer and rancher in America comes from the banking industry.

The erosion of equity and the declines in cash flow of many farm borrowers has been, in some cases, severe. Even some of the most productive, best managed and best capitalized farm customers had a tough time last year and they are worried about what will happen this year and next.

In an effort to honestly examine the future of agriculture and come together in a proactive manner to find solutions, the American Bankers Association formed a special task force on 21st century agricultural banking. Bankers from all over the country were assembled to discuss what tools bankers will need to meet the demands of their customers immediately, and what they will need to continue in their role as the largest provider of credit to this vital national industry. The Task Force report, ***Positioning Agriculture and Rural America For the 21st Century***, is the result of months of meetings and discussions. It contains specific and actionable recommendations from the banking industry that will help to ensure that the flow of credit to this troubled sector of the economy is unimpeded. A copy of the report is attached.

The Focus of the ABA Task Force on 21st Agricultural Banking

The ABA brought bankers together from every major agricultural region in the United States. They focused on issues that had special relevance to bankers and on issues that bankers could strongly influence. The Task Force recognized that the immediate problems in agriculture (universal and historic low commodity prices) were not going to be solved by the banking community. The report does not contain any recommendations on how to get the price of corn over $3 per bushel. It does address the areas where the banking industry has a legitimate stake. It prioritizes our recommendations in terms of their immediacy.

Below is brief review of the report.

Section 1. **A New Framework is Needed for Farmers and Bankers to Manage Agricultural Risk**

To deal with the current situation the report recommends tools to help banks and their customers better manage agricultural risk. The first recommendation is that the USDA, Farm Service Agency guaranteed loan programs must be adequately funded. The task force could not think of any other single tool that the banking industry could use to deal with the current situation more than these credit guarantees. As Congress contemplates how the federal government should respond to the needs of the agricultural sector during this difficult year and in the future, adequate funding for the guaranteed loan programs offered by the USDA must be a priority. The guaranteed loan programs are the most cost effective and highest impact tools that Congress can provide quickly. This program is not an answer to low agricultural prices, but it is an effective short-term response to credit problems faced by farmers and ranchers who are suffering from the effects of low commodity prices.

Some 48,000 farmers and ranchers have 65,000 loans that are guaranteed by the Farm Service Agency (FSA). The banking industry writes over 80% of all of the guaranteed loans made under this program. Each year FSA receives approximately 15,000 requests for new guaranteed loans. Today, the guaranteed loan portfolio has about $6.8 billion outstanding and currently only about 2.4% of the payments are past due. To put that in context, the banking industry's non guaranteed loan portfolio to farmers and ranchers currently has a past due rate of 1%. Considering the fact that FSA guaranteed loans are made only to those farmers and ranchers who have some type of credit weakness, this portfolio of guaranteed loans is performing very well under the present circumstances.

There has been unprecedented demand for the program this year. For the last 3 years, the USDA has averaged about $1.6 billion in guarantees per year. In 1999, just through May, USDA has guaranteed over $2.1 billion in loans. Twice this year USDA announced that all funding had been exhausted. These funding shortages have caused tremendous disruptions within the agricultural community.

ABA feels there is nothing more important that Congress can do that would help ensure that the banking industry remains able to deliver credit to all farmers and ranchers than to make sure that the FSA guaranteed loan programs are adequately funded.

The Task Force reviewed crop insurance and agreed that the program is not working adequately for farm borrowers. The report contains a series of recommendations concerning crop insurance. The most significant one for the current situation is that farmers need a program that adequately covers them for both crop losses and for price fluctuations at a cost to the producer that fits the current economic climate.

The Task Force supports the concept of a special savings vehicle for farmers to use to save for bad times. It does not endorse any particular savings plan. The purpose of such an account is to allow a farmer to save money in good times so that he has the funds available in bad times. It is essential that there be absolute certainty about the safety of the farmer's savings account; therefore the Task Force strongly recommends that the funds be deposited in a federally insured deposit account.

Section 2. **Create New Avenues for Local Bank Access to National Capital Markets**

In this section the Task Force looked at some tools needed by the banking industry for the longer term. It strongly supports increased access to the Federal Home Loan Bank (FHLB) through legislation that would allow community banks to pledge their agricultural and small business loans as collateral for additional FHLB advances. Many rural banks are experiencing a shortage of deposits. If a bank were able to pledge its $100 million portfolio of agricultural loans as collateral to the FHLB for additional advances, it would be able to generate substantial, additional loans in the communities it serves.

The Task Force noted that banks, especially small banks, are restricted to investing 5% of their capital in Community Development Corporations, thus limiting the role rural banks can play in providing innovative financing or equity capital. The report recommends increased regulatory flexibility for small banks to allow them to make worthwhile investments in Community Development Corporations.

Section 3. **New Tools for New Ventures and Opportunities in Rural America are Needed.**

In this section, the Task Force expanded its view even further along the horizon to look at ways that the banking industry could be more involved in financing the farmers and ranchers of tomorrow, and ways to improve the success rate of those that start new enterprises.

The Task Force looked at state aggie bond programs and made several specific recommendations about how they may be improved. Aggie bonds are state industrial revenue bonds ear-marked for agricultural borrowers. Because the bonds are exempt from federal and state taxes, banks that use them are able to offer beginning farmers below market interest rates. Because they work so well, the 15 states that have aggie bond programs frequently have more demand than they can meet.

The Task Force addressed the demand issue by recommending that aggie bonds be exempt from federal industrial revenue bond caps. It also recommends that USDA and SBA guarantees be allowed on aggie bonds (at present federal guarantees can not be attached to tax exempt bonds).

Finally, the task force recommends that rural Small Business Development Corporations be created by a partnership of federal, state and private sector resources to give beginning farmers the business skills they need to survive.

Credit Can Not Replace Profitability

Not all farm and ranch operators can survive in the new, more volatile environment that faces agriculture. Some will decide to exit farming. Some will take advantage of off-farm employment opportunities and will farm on a part-time basis. Others will find opportunities to successfully grow their businesses. As the primary credit providers to American agriculture, bankers will work with all of their agricultural customers to help them find where they best fit in this new environment.

Bankers will work with their customers to restructure debt, to provide credit for operating expenses for the coming year, to find ways for beginning farmers to get started and to provide the financial services and financial stability that rural communities need. Banks will continue to provide credit to those farmers and ranchers who can make the necessary and rapid adjustments to the new global environment. Even in this uncertain environment, competition for safe and sound credit opportunities is strong, and that competition among lenders benefits the producer.

Credit can not be used as a replacement for earnings and profits. The key lesson learned from the farm crisis of the 1980s is that agricultural businesses must be profitable to successfully manage their debt obligations. The focus on profits rather than on asset appreciation is a hard-learned lesson that we in the credit business must never forget.

Summary

Rural American has an uncertain future. Unfortunately, most agricultural indicators are negative for the foreseeable future. The banking industry has a substantial commitment to agriculture- - over $70 billion in loans at the end of 1998 which represented forty-one percent of all outstanding agricultural credit.

The ABA believed that it was vital for our industry to come forward with positive recommendations about how the banking industry can better work with their customers during this very difficult and uncertain time. The Task Force report provides a workable framework for this cooperation.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

OCT 26 1999

Honorable James M. Talent
Chairman, Committee on Small Business
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

On September 29, you held a hearing on "Helping Agricultural Producers Re-Grow America." I want to commend you for focusing on this important sector of the American economy and addressing the problems of rural areas that are not currently enjoying the prosperity shared by many.

The hearing raised several issues about which I feel very strongly, and it reinforced the U.S. Small Business Administration's (SBA) preparedness to address these issues. I was particularly struck by the call for Government programs that can help the agricultural community shift focus to small business ventures and "reach up the agricultural marketing chain." SBA has a multitude of current and proposed programs that deliver a continuum of services for all small business, including agricultural-related businesses. While I appreciate looking to the most obvious source of help for farmers, the United States Department of Agriculture (USDA), I think it would be a missed opportunity if I didn't highlight some of the ways SBA can help now and in the future.

SBA's core products and services offer the agricultural community fundamental small business tools. It was mentioned in the hearing that the Small Business Development Centers (SBDC) provide assistance in writing business plans and finding the right sources of financing. However, the SBDCs are just one of SBA's programs that can assist the agricultural community in taking the next step in forming vertically integrated small businesses.

Tapping New Markets

I was impressed with the National Pork Producers Council's study of the Hispanic community. It proves how the face of small business is changing as the faces of small business owners and consumers are changing. It is not news to SBA that a wealth of opportunities exists in the buying power of untapped markets.

Perhaps the largest and most accessible tool for reaching untapped markets is the Internet. Congressman Thune spoke on the importance of getting the agricultural community "on-line," and I couldn't agree more. Every time I meet with small business owners I impress upon them the importance of the Internet and two of SBA's most closely related programs, PRO-Net and HUBZone.

Listing with PRO-Net and certifying as a HUBZone firm offer new ways for agricultural small businesses to market existing and value-added products and gain procurement contracts in untapped markets nationwide. SBA has worked hard to develop PRO-Net into the 'one stop' source for Federal and private sector procurement opportunities. We welcome agriculture-related businesses to the list. Additionally, the HUBZone program offers certified agricultural small businesses a source for identifying Federal procurement possibilities. With HUBZones existing in many rural areas, it is important that the agricultural community be aware of how this program can work for them in exploring new markets and forming new businesses for value-added products.

Research and Development

Many witnesses spoke about the need for more research and development of value-added and alternative uses to agricultural products. The Small Business Innovation Research (SBIR) program came to mind as I heard about the soy-based material that could be used to prevent oxidation of exposed metal structures. It demonstrates that the possibilities of using traditional cash crops in non-traditional ways are endless. The SBIR program is no stranger to funding this type of research. In the past few years, SBIR awards have funded research for turning raw agricultural materials into everything from alternative fuels, to pesticides, to low-caloric substitute sweetners. As SBA and Congress push to see more SBIR awards in rural states, I ask that you help us make the program more visible to your rural constituents and let them know how it can work for them – especially in the development of 'value-added' products and uses.

Equity and Technical Assistance

Witnesses repeatedly referred to the need for equity and technical assistance. As more entrepreneurial endeavors are born through technology, there is a greater need for access to capital and operational business assistance. SBA loan programs offer access to financing for small businesses, including start-ups. However, there is a need for the type of patient capital that only equity investing can provide.

For more than 40 years, Small Business Investment Companies (SBIC) have made equity and equity-type investments crossing all Standard Industry Classification (SIC) Codes with ties to agriculture. In the last 3 years, SBICs have made $55.8 million in agriculturally specific SIC Code investments and many more to high tech, manufacturing, and service industries within the agricultural marketing chain. However, SBICs tend to be located in high-growth, high finance areas and expect very significant rates of return on their investments. With little SBIC presence in rural farming areas, the need for equity cannot be truly fulfilled. As you know from the witnesses' testimony, the potential exists.

The proposed New Markets Venture Capital (NMVC) program fits an important need for helping the agricultural community reach up the marketing chain. NMVC companies could provide equity *and* hands-on business operational assistance to boost stagnant rural economies and foster entrepreneurial development. NMVC companies could produce the ideal model to revitalize and "re-grow" rural America by assisting the *entire* business community of an agriculturally dependent area. NMVCs could work with other Federal, state and local economic development programs to ensure long-term small business successes, provide jobs, and simulate rural economies. NMVC companies would complement the SBIC, SBIR, HUBZone, and other SBA programs to tap new markets and create new business and finance networks across the country. I look forward to working with you and Members of the Committee to make the NMVC program a reality.

Business "Cookbooks" for Farmers

The hearing also raised the importance of better coordinating Government programs designed to assist agriculture and agriculture-related businesses. I agree. One witness coined this idea as developing a "cookbook" of Federal services. I will be discussing ideas with Secretary Glickman on how our agencies can better work together to help farmers and small businesses in agriculturally dependent communities.

As for SBA, I see our continuum of financial and entrepreneurial development services as an already published "cookbook" for assisting entrepreneurs and small business owners, including farmers. Furthermore, the New Markets Venture Capital program is a next important addition to our menu of products and services.

Mr. Chairman, you indicated the direction of the Small Business Committee is to hold more hearings and possibly develop legislation on "re-growing" rural areas. I am committed to working with you and the Committee toward this end and would be happy to address these issues from SBA's perspective. It's easy to see when farmers are hurting, the small businesses that serve them hurt, too. I feel strongly that we can help best by empowering all communities, making sure no one is left behind.

Sincerely,

Aida Alvarez

Aida Alvarez
Administrator